Entrepreneurial Finance in Egypt: Examination of the Opportunities for a Venture Capital Industry from an Institutional Perspective

ALSHARIF, AHMED,ABDULLATIF

Durham
University
Business School

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Entrepreneurial Finance in Egypt: Examination of the Opportunities for a Venture Capital Industry from an Institutional Perspective

Ahmed Abdullatif Alsharif

Supervisors:

Mrs. Anne Woodhead
Professor David Kirby

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Abstract

This thesis aims to generate an understanding on entrepreneurial finance in Egypt. Furthermore it explores the opportunities for a venture capital industry as a promising tool in entrepreneurial finance. As one of the MENA region's emerging economies, Egypt is facing economic challenges and high unemployment rates. The Arab spring uprisings added to the pressures upon the economy of Egypt; however, it managed to ignite an entrepreneurial spark among the youth population. Access to finance is an evident hurdle facing entrepreneurship in Egypt. Thus promoting entrepreneurial finance as a growth engine in anticipation to overcome unemployment and slow rates of start-ups might be a plausible solution. Through utilising an institutional theory lens and its institutional determinants, regulatory, normative, and cognitive forces, were found useful to analyse the current entrepreneurial finance environment.

This research is an exploratory research; it takes into account both the supply side and demand side of entrepreneurial finance in Egypt. It adopts a qualitative approach for in-depth understanding of the domain and a grounded approach in regard to data gathering for its limited availability on the subject taking the form of a naturalistic enquiry. In doing so it follows an inductive approach to understand the interaction among the supply and demand of finance and the determinants shaping it. This thesis built on secondary data supplied by current research and reports and the primary research conducted via in-depth interviews and participant observations and analysed it from an institutional perspective.

According to the findings of this research, it was plausible to argue that the regulatory pillar was held most accountable for the under development of entrepreneurial finance in Egypt. The normative and cognitive pillars both have supportive and inhibiting factors. However, the overall effect of normative and cognitive pillars could be positive if policy makers were able to factor in the cultural and normative forces in policies promoting entrepreneurial finance. The thesis further suggests policy recommendations to enhance entrepreneurship, entrepreneurial finance, and a vivid venture capital industry in Egypt.

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Abbreviations

VC	Venture Capital
US	United States of America
UK	United Kingdom
GCC	Gulf Cooperation Council
GOE	Government of Egypt
EFSA	Egyptian Financial Regulatory Authority
OECD	Organisation for Economic Co-operation and Development
GDP	Gross Domestic Product
GNI	Gross National Income
CBE	Central Bank of Egypt
MSME	Micro, small and medium-sized enterprises
SME	Small and medium-sized enterprise
GEM	Global Entrepreneurship Monitor
TEA	Total Entrepreneurial Activity
HGE	High Growth Enterprise
HNWI	High Net Worth Individual
SFD	Social Fund for Development
FDI	Foreign direct investment
AIM	Alternative Investment Market
MBO	Management Buy Out
MBI	Management Buy In
IFC	International Finance Corporation
GAFI	General Authority for Investment

MOF	Ministry of Finance
MOI	Ministry of Investment
EU	European Union
RDI	Research, Development and Innovation Programme
NGO	Non-governmental organisation
R&D	Research and development
MSEs	Micro and small-sized enterprises
NILEX	Nile Stock Exchange
EGP	Egyptian pounds
GBP	Great Britain Pound
USD	United States Dollar
ICT	Information and Computer Technology
IT	Information Technology
USAID	United States Agency for International Development
CIDA	Canadian International Development Agency
MENA	Middle East and North Africa
MCIT	Ministry of Communications Information and Technology
MEPEA	Middle East Private Equity Association
IPO	Initial Public Offering
CGC	Credit Guarantee Company
ELA	Egyptian Leasing Association

Chapter One: Introduction

1.1 Introduction

The perception of entrepreneurship has changed over the last three decades; it has become widely appreciated and perhaps most valued for employment creation (Carter and Jones-Evans, 2006). During the last fifteen years a large volume of research has addressed this subject in business schools and among practitioners promoting entrepreneurship both academically and practically (Eid, 2006). It is widely demonstrated that entrepreneurship and small businesses contribute to economic growth (Wennekers and Thurik, 1999; Audretsch, 2002; Carree, Van Stel, Thurik, and Wennekers, 2002; Acs and Virgill, 2010) through job creation (Reynolds, 2012; Fritsch, 2013) and knowledge spill-overs (Audretsch, Keilbach, and Lehmann, 2006). However, their growth potential was found to be limited by scarce access to external finance (Becchetti and Trovato, 2002), and thus holds back innovation and growth (Hyytinen and Toivanen, 2005). SMEs face higher constraints in accessing external finance than large corporations (Beck and Demirguc-Kunt, 2006), hence the topic of SME access to external finance is of high importance to both academics and policy makers in both developed and developing countries (Berger and Udell, 2006). The topic of entrepreneurial finance is of growing interest to entrepreneurship in general and the financial sectors all over the world (Denis, 2004). How and why entrepreneurs finance their businesses: whether internally via self-finance and bootstrapping (Bhidé, 1992; Winborg and Landstrom, 2001; Ebben and Johnson, 2006; Lam 2010) or externally via debt or equity became the interest of many researchers (Berger and Udell, 1998; Hamilton and Fox, 1998; Cassar, 2004; De Bettignies and Brander, 2007). Furthermore, researchers explored the different tools for entrepreneurial financing such as the fields of angel financing (Lerner, 1998; Mason, 2007;

Schwienbacher, 2007; Fairchild, 2011; Kerr, Lerner and Schoar, 2014), most frequently venture capital (Tyebjee and Bruno, 1984; Fried and Hisrich, 1988; Gorman and Sahlman,1989; Norton, 1996; Amit, Brander and Zott, 1998; Gompers and Lerner, 1999; 2001), and the most recent crowdfunding (Lambert and Schwienbacher, 2010; Schwienbacher and Larralde, 2010; Ordanini, Miceli, Pizzetti, and Parasuraman, 2011; Belleflamme, Lambert, and Schwienbacher, 2013) as primary sources for entrepreneurial finance.

In fact, the venture capital (VC) industry has become a worldwide phenomenon in the financial markets and developed to be a significant provider of capital to small and young firms which cannot raise capital elsewhere (Gompers and Lerner, 2001). Thus, it remains an essential financing vehicle for entrepreneurs especially in the high technology sector (Dossani and Kenney, 2002). According to Jeng and Wells, the VC industry might be an influential component for a nation's economic growth through commercialising technological innovation (2000). They specified the role of the VC industry together with the Silicon Valley in the United States (US) as a clear example of such benefit. Salehizadeh (2004) argued that the next "logical group" to gain from the VC industry is the emerging markets by increasing the VC investments in those countries and eventually improving their economic status. With great enthusiasm towards venture capital, many developed countries tried to replicate the model of the successful US and United Kingdom (UK) approaches resulting in a few success stories (Lerner, 2009). In addition, countries in transitional and emerging economies sought after synthesising the environment for creating and stimulating an indigenous venture capital industry and furthermore, attracting foreign VC firms (Wright, Pruthi, and Lockett 2005b; Bruton, Fried, and Manigart, 2005; Lerner, 2009).

1.2 Motives of the Study

The growing interest in entrepreneurship worldwide, in addition to its role on economic growth (Wennekers and Thurik, 1999; Audretsch, 2002; Carree *et al.*, 2002; Acs and Virgill, 2010) and job creation (Reynolds, 2012; Fritsch, 2013) was an important motive for this study. The researcher was prompted to explore how Egypt could benefit from its youth and potential entrepreneurs through an understanding of the role of entrepreneurial finance in supporting entrepreneurship and innovation. Thereby, determining the current options for entrepreneurs in Egypt in financing their ventures and the prospect for a venture capital industry in Egypt was the foremost motive for this study. In so doing, to understand the reasons and determinants within the current situation while making recommendations to develop the domain of entrepreneurial finance in Egypt.

In 2013, Egypt's population was over 82 million. The Gross Domestic Product (GDP) growth was 6.8% in 2006, reached 7% in 2007 and 2008, then declined to 5% in 2009 and 2010, and further declined to 2% in 2011, 2012, and 2013 after the January revolution. The GDP doubled from 2007 from approx. 130 billion USD to 257 billion USD in 2012 and reaching 272 billion in 2013. Yet, the Gross National Income (GNI) per capita (Atlas method) was 1,390 USD in 2006 and reached 2,980 in 2012, and 3,140 in 2013 with problems of poverty escalating from 19.6% of population under poverty line in 2005 to a staggering 25% in 2011, high unemployment (approx. 10%), and high inflation rates reaching 7.6% in 2006 and reaching over 10% in 2011 and 12% in 2012 (World Bank, 2007; 2013; 2015).

Escalating unemployment and the increasing need for job creation has long been the biggest challenge facing the Middle East and North Africa (MENA) including Egypt (Youssef, 2004). Job creation is the first priority to MENA region and the situation is expected to worsen with the current political and economic instability (O'Sullivan, Rey, and Galvez, 2011). The combination of poverty and unemployment triggered the Arab spring uprising that started in late 2010 in Tunisia, followed by Egypt in January 2011, and then Libya, Yemen, and Syria. Those populous uprisings were also against dictatorship, corruption, and police brutality; however, a life with dignity away from the shame of poverty and unemployment was paramount. The Arab spring, that had overthrown most of the state regimes at that time, added to the economic burdens and the need for major economic and political reforms (O'Sullivan *et. al*., 2011). Foreign direct investment (FDI) and tourism were the most affected in Egypt (O'Sullivan *et. al*., 2011). Worth to mention, the young people of the countries that witnessed the uprisings were the main foundation and contributor to their success. The number of people between the age of 15 to 24 in MENA was nearly 90 million in 2010 with half of the total population under the age of 25 (Roudi, 2010). However, youth unemployment reached as high as 50% in Palestinian territories, 30% in Saudi Arabia and 25% in Jordan and Egypt (O'Sullivan *et. al*., 2011). The large youth population of the region could be considered as an economic opportunity if it were well utilised and the youth was properly educated and ready for the job market (Roudi, 2010). Nevertheless, the challenge lies in issues of unemployment, underemployment, female unemployment (Gender gap), brain drain, and increasing cost of livings that adds to the burdens of the youth of the region (Roudi, 2010).

In the MENA region, unemployment is even high among the highly educated; worth to mention, 70% of non-agricultural employment in Egypt is in the private sector (O'Sullivan *et. al*., 2011). According to Veganzones-Varoudakis (2006), prior to the 1990s education in MENA was directed towards preparing youth to state jobs, and therefore they were not ready for the private sector job market. This hampered the economic growth of the region and caused lower productivity levels compared to other developing countries such as South-East Asia.

The MENA region is considered one of the emerging markets that can possibly benefit from the private equity (PE) and VC industries (Eid, 2006). The high unemployment rates signal the urgency to promote start-ups to absorb the continuing escalating numbers of unemployed, yet qualified youth in the region especially in non-oil producing countries (Eid, 2005). Entrepreneurship and entrepreneurial finance, in the form of PE/VC, emerged to be an adequate and reliable solution for such problems and was proven by other economies to create jobs and help in their economic growth (Eid, 2006). This research focuses on the case of Egypt, as one of those countries seeking a rescue boat to overcome the chronic unhealthy symptoms of unemployment and slow rate of start-ups. The domain of entrepreneurial finance is thoroughly investigated focusing on the equity side of financing for its greater relevance to entrepreneurial ventures. Its VC industry is deliberately separately analysed as the main vehicle funding high growth firms appreciated for their contribution to innovation, economic growth, and job creation. In addition, the research provides policy recommendations to promote a favourable entrepreneurial finance environment and a vibrant VC industry.

1.3 Entrepreneurial Finance in Egypt

Access to finance has long been an issue for the Egyptian business sector; it has been underdeveloped till the early 2000s even when compared with other GCC MENA region (OECD, 2010a). Moreover, access to finance remains highly unfavourable for Micro, Small, and Medium Enterprises (MSMEs) all over the MENA region; it is estimated that the financing gap for MSMEs in MENA is 320 to

390 billion USD (IFC, 2011). In Egypt, 49% of nascent entrepreneurs will totally self finance their ventures while 51% will seek external funding (Hattab, 2011). The start-up capital required to start a business is of a median of 50,000 EGP; 91% of businesses can be started with 500,000 EGP or less (Hattab, 2008).

In 2004, the Government of Egypt (GoE) had undergone major reforms in the financial sector including the banking sector, introducing a centralised non-banking financial services regulatory authority (Egyptian Financial Regulatory Authority, EFSA)**,** improving the stock market exchange, attempting to enhance risk capital, developing credit guarantee schemes, and improving credit rating and quality of information (OECD, 2010b). However, most of the current institutions needs to improve their performance, bankruptcy laws needs to be updated, risk capital needs more promotion, and financial literacy has to be improved (OECD, 2010a).

Bank credit is the dominant and mostly the only significant source of finance to the private sector in the MENA region (Rocha, Arvai, and Farazi, 2011). On the other hand, SMEs access to bank finance is limited all over the MENA region with a very small percentage of the total lending portfolio of an average of 8% compared to 16.2% for middle income countries and 22.1% for high income countries; Egypt is no exception counting to 5% of the total lending in 2009 (Rocha *et. al.*, 2011).

Sources of entrepreneurial finance are either through internal, personal resources or business earnings, or external resources, via debt, or equity, or a combination of all (elaborated in section 2.5). Among external equity options, there are formal alternatives through public markets or venture capital and informal financing such as family and friends (love money) or business angels (see section 2.8). Regarding the informal equity funding in Egypt, the estimated amount of ‘angel’ financing was estimated to be 8.13 billion EGP (approx. 750 million GBP) which is almost 1% of the GDP in 2008; over 35% expects no return at all which is in most cases "love money" where the investment is in a family member's businesses (Hattab, 2008). Regarding the formal VC industry, VC in Egypt is relatively nascent and highly inclined towards late stage financing often known as private equity. It is also very small with around 15 operating VC/PE firms, mostly late-stage funding PE firms. This research acknowledges the different sources of entrepreneurial finance, whether debt or equity, as one integral segment serving entrepreneurial ventures. However, there is a deliberate focus on the equity financing tools such as angel investment, crowd funding and venture capital as an under researched domain (See section 4.6). The greater focus was on VC funding for its significance in financing high growth firms that are believed to foster innovation and being the greatest contributor to job creation. Reasons behind the need for promoting a venture capital industry in Egypt among other countries in the MENA region, precisely early-stage and start-up funding, prevailed to be of great importance (Eid, 2011). The January revolution in 2011 evidenced this importance; the urgent need to create jobs and capitalise on the young population in Egypt and the region suggests further attention towards entrepreneurial finance in general and VC in particular. In addition, the unprecedented entrepreneurial momentum that is taking place after the revolution needs to be captured and directed to create a positive impact on the economy. It should be well noted that this research is not presuming that entrepreneurial finance or specifically VC is capable of tackling the MSMEs finance gap, however it suggests VC will support a significant underserved segment of early stage, innovative and high growth entrepreneurial ventures.

1.4 Research Aims

This research aspires to generate an understanding of the domain of entrepreneurial finance in Egypt. It explores the major impediments and enabling factors shaping its current status. Moreover, it explores where the VC industry development in Egypt currently stands compared to the MENA region and other developing countries. To achieve the aims of this research, this study have three main objectives.

First: to explain the current status of entrepreneurial finance in Egypt by mapping the financial alternatives and the institutional determinants shaping it.

Second: to understand the development of the venture capital industry by understanding the surrounding institutional factors affecting its growth.

The first and second research aims are fulfilled through the two main research questions and sub-questions as illustrated in section (1.5). The answers of these questions would lead to the third objective of the research.

Third: to develop policy recommendations for an Egyptian venture capital model that would better fit the case of Egypt in the light of the current institutional forces.

1.5 Research Questions

To achieve the research objectives, this research seeks to answer the following questions. There are two main questions each with two sub-questions to clarify enablers and hurdles facing entrepreneurial finance and the venture capital industry in Egypt separately.

First Question: What are the main institutional determinants shaping entrepreneurial finance in Egypt?

1.1- What are the major hurdles impeding the development of entrepreneurial finance in Egypt?

1.2- What are the conducive factors supporting the development of entrepreneurial finance in Egypt?

Second Question: What is the prospect for the development of a venture capital industry in Egypt?

2.1 What are the current institutional forces supporting the growth of a venture capital industry in Egypt?

2.2 What are the current institutional forces encumbering the progression of a VC industry in Egypt?

1.6 Research Methodology

This research is an exploratory research; it takes into account both the supply side and demand side of entrepreneurial finance in Egypt. It adopts a qualitative approach for in-depth understanding of the domain and an approach similar to grounded theory in regard to data gathering in being grounded and immersed in the data. This approach was adopted for the limited availability of the data on the subject while taking the form of a naturalistic enquiry. In doing so it follows an inductive approach to understand the interaction among the supply and demand of finance and the determinants shaping it. The units of analysis are structure focused in the form of organisations, institutions, and entrepreneurs. It is also geographically focused thus studying the case of Egypt as part of the MENA region (Further elaboration on research design and methodology in Chapter 5). The thesis builds on secondary data supplied by current reports and research while adding to it the primary research conducted on the financiers, venture capital market, entrepreneurs, policy makers, and industry professionals in Egypt and analyse it from an institutional perspective on both macro and micro levels (Discussions on the theoretical framework takes place in chapter 4). On the macro-level, the thesis will test the effect of institutional forces on the development of entrepreneurial finance and VC industry. On the micro-level, the research analyses the entrepreneurs' and financiers' behaviour and investment decisions. In addition, the thesis investigates the capacity of a venture capital industry to succeed, grow, and help in the growth of the Egyptian economy.

1.7 Implications for Theory and Practice

As little is known of entrepreneurial finance in the Africa and the MENA region, this research contributes to the knowledge of entrepreneurial finance and venture capital in those regions through the case of Egypt. The theoretical implications of this research would directly contribute to the work on institutional theory and its usage. It adds to the literature which utilises the theory in industry analysis in emerging economies and especially entrepreneurship and the VC industry. In addition, it aims to enhance the literature of entrepreneurial finance and entrepreneurship in general. On the practitioners' level, it aspires to assist investment decisions of entrepreneurial financiers and entrepreneurs operating in Egypt, whether local, regional, or international. Moreover, it recommends policy changes to improve the current entrepreneurial finance environment and develop the emergence of the VC industry and consequently promote entrepreneurship and innovation in Egypt.

1.8 Thesis Structure

The thesis is introduced in **Chapter one**, followed by an overview of existing entrepreneurial finance literature (**chapter two**). This overview is divided into two sections; first the literature on entrepreneurship and economic growth highlighting the literature on entrepreneurship in developing economies, its effect on job creation, and the role of government on promoting entrepreneurship. The second part is concerned with the literature on SMEs and entrepreneurial access to finance, including finance gap, and the literature on capital structure. Further literature on the available tools of financing for entrepreneurs are reviewed including bootstrapping, angel finance, crowdfunding, and venture capital.

Chapter three contextualises the research for the case of Egypt. It starts with the socio-economic conditions of Egypt as part of the MENA region. It presents the current data on entrepreneurship and challenges regarding entrepreneurial finance in Egypt. It also provides an insight on the main regulatory financial institutions and the current debt financing tools as well as equity. This includes governmental initiatives as well as alternative financial tools such as angel financing and venture capital.

Chapter four presents the theoretical foundation of this research. It provides an argument for the choice of institutional theory and its fitness for this work. It introduces the categorisation of institutional determinants into regulatory, normative, and cognitive pillars that are used by this research in the analysis section. It further identifies the gap in literature which leads to the research questions.

Chapter five describes and explains the rationale behind the research design and methodology of the thesis. It starts with the research design and its exploratory nature. It provides the argument for choosing a qualitative and grounded approach data gathering method. Furthermore, the chapter identifies the sampling strategy and data collection methods, which comprised in-depth interviews with the main stakeholders and participant observations. It also provided the data analysis method using QSR-NVIVO (computer aided software for qualitative analysis) and validation methods. The chapter ends with the study timeframe and limitations.

Thereafter is the discussion on the findings which is divided over chapters six and seven. **Chapter six** focuses on the findings regarding entrepreneurial finance in Egypt. It identifies the major sources of capital for entrepreneurs in the Egyptian market. It then presents the findings on the major hurdles affecting entrepreneurial finance as well as the conducive factors shaping the domain. It answers the first question of the research illustrating the institutional determinants shaping entrepreneurial finance in Egypt.

Chapter Seven, the second chapter of the findings, answers the second question regarding the opportunities for a VC industry in Egypt. It illustrates the magnitude of the industry in Egypt and the MENA region. It further analyses the current macro-perspectives on the industry level and the micro-perspectives on the firm level of the VC industry under current influential institutional forces. It also provides an understanding of the influence of Islamic finance on the industry and its development. It finally presents policy recommendations for enhancing a VC industry in Egypt and suggests a localised model of VC under current institutional forces.

Chapter Eight concludes of the thesis. It presents the key findings in the light of the research objectives and further emphasises on the contribution of the research findings to knowledge and its implications to theory and practice. It is concluded by the research limitations and direction for future research.

1.9 Ethical Implications

This research had no health, safety or legislative hazards. Moreover, the ethical perspectives were taken into consideration during all the interviews. Each interviewee gave an informed consent of the nature of the research. Confidentiality and level of disclosure was approved, and anonymity was offered and implemented among all interviewees. In addition, interviewees were informed of the recordings while explicitly giving their consent and had the option to stop at any time if they felt inconvenient. The interviewees were offered a copy of the write-up of their interviews for further approval whenever requested.

Chapter Two: Overview on Entrepreneurial Finance

2.1 Introduction

Entrepreneurial finance is an interdisciplinary domain that lies mostly among the literature of entrepreneurship, finance, and economics. To understand the economic implications of this domain, one must recognize the distinguishing topics of entrepreneurship, the demand side of this specific type of financing, as well as its impact on economic development. This thesis explores entrepreneurial finance in Egypt as one of the developing countries attempting to overcome its economic burdens by enhancing its entrepreneurial activities. Thus understanding entrepreneurship in developing countries and its effect on economic growth, innovation, and job creation would be of high relevance to this review. Moreover, it will explore the available financial tools that are widely applied to fund entrepreneurs in developed and developing economies. This chapter is divided into two sections, first it begins with the observations in the literature on entrepreneurship and economic growth in developing countries and how the literature examines the effect of entrepreneurship on economic development and regional growth followed by a summary and direction for the second section. The second part of the review covers entrepreneurial finance and the major themes on SMEs' access to finance and the finance gap. It is followed by the capital structure decisions made by entrepreneurs and the available financial mechanisms for entrepreneurial ventures including debt financing and equity financing. The chapter ends with a summary and discussion on the significant topics relevant to entrepreneurial finance.

2.2 Entrepreneurship and Economic Growth

2.2.1 Entrepreneurship

The field of entrepreneurship may be defined as *"the scholarly examination of how, by whom, and with what effects opportunities to create future goods and services are discovered, evaluated, and exploited"* (Shane and Venkataraman, 2000: p. 218). A sociological account based on the demand side perspective on how, where, and why new ventures are formed was discussed by Thornton (1999). There is a growing work on entrepreneurship in economics, among various branches of behavioural economics and new institutional economics which are found useful in entrepreneurship research (Minniti and Lévesque, 2008).

It is important to elaborate on the definition of entrepreneurs and differentiate from SMEs which would be considered the larger domain. Literature has elaborated on the definition of entrepreneurship (Shane and Venkataraman, 2000; Carter and Jones-Evans, 2006) and many have considered entrepreneurship as an activity that can take place in an organisation 'Intra-preneurship' (Shane and Venkataraman, 2000); or for social causes 'social entrepreneurship' (Nicholls, 2006); or in high growth, high potential ventures (Henrekson and Johansson, 2010). There is no general agreement on the definition of entrepreneurship; hence it is worth focusing on examining the process of entrepreneurship rather than trying to define it (Delmar, 2006). However, there remain distinctions between small business owners and entrepreneurial ventures; *"not all owner managers can be regarded as entrepreneurs, nor are all small businesses entrepreneurial"* (Kirby, 2006: p.291). Thus entrepreneurship and SMEs are not the same, they overlap at some points; furthermore they are both important for a country's economy (Thurik and Wennekers, 2004). However, in developing countries the distinctions between SMEs and entrepreneurs are even more blurred.

This might be explained by relatively less innovation, in addition to the differences in perceiving innovation in the first place. Some of those who might be perceived as entrepreneurs in developing countries could be counted as SMEs in developed countries and vice-a-versa. High growth and high potential ventures were found to be the most economically rewarding, as well so are the most commonly referred to in defining entrepreneurs in general. Therefore, an increasing literature is in favour of this clear differentiation, especially on the argument of the economic significance of high growth enterprises (HGEs) (Timmons and Spinelli, 2003; Van Praag and Versloot, 2008; Henrekson and Johansson, 2010), known as 'Gazelles' (Birch and Medoff, 1994). Notably, the Global Entrepreneurship Monitor (GEM) classifies necessity-motivated entrepreneurs and opportunity-motivated entrepreneurs separately, which partially helps for this differentiation.

There are different perspectives in attempting to understand who entrepreneurs are. Two of the best known approaches to entrepreneurship are the "Schumpeterian" and the "Kirznerian" Entrepreneur (Acsand Virgill, 2010). The Schumpeterian, in reference to Joseph Schumpeter, recognises that development is a process of "disturbance" and change initiated by entrepreneurs causing what is known as 'creative destruction' (Schumpeter, 1947). Schumpeterian concept of innovation (new products, new market, and new processes) takes the widest possible definition of entrepreneurship (Acs and Virgill, 2010). On the other hand, Kirzner (1997) argues that most of the time markets are in disequilibrium due to errors caused by other entrepreneurs and the alert and imaginative entrepreneur takes the opportunities and acts to correct the market. Thus the learning experience from failure and success is a prerequisite for a vibrant entrepreneurial environment. In a study by Minniti and Levesque (2010), they classified entrepreneurs into two distinct categories; the imitative 'Kirznerian arbitrageur' and the innovative entrepreneurs. Research-based entrepreneurs are involved in commercializing original technological discoveries while incurring R&D expenditure; on the other hand, imitative entrepreneurs mobilize resources to expand existing markets by increasing competition and promoting efficiency (Minniti and Levesque, 2010).

Notably, the definition of entrepreneurship is beyond the scope of this research. Hence this research will adopt the widest possible definition for entrepreneurship and will address the high innovative entrepreneurs and HGEs separately whenever appropriate.

2.2.2 Entrepreneurship and Developing Economies

A growing body of researchers found empirical evidence supporting a positive relationship between entrepreneurship and economic growth (Wennekers and Thurik, 1999; Audretsch, 2002; Carree *et al*., 2002). Economic development requires change and the entrepreneur is the agent of this change by filling the gap of underdeveloped markets and responding to market imperfections (Acs and Virgill, 2010). Testing the effect of entrepreneurship on economic development was found to be not an easy task; using the indicator of Total Entrepreneurship Activity (TEA) utilised by the Global Entrepreneurship Monitor (GEM) report, Van Stel, Carree, and Thurik (2005) found that the impact of TEA on GDP growth was not a simple linear one. They found that it had a negative effect in developing countries while a positive one in developed countries suggesting entrepreneurship plays a different role in countries in different stages of economic development. The findings were partly explained by the absence of large corporations and the presence of many small entrepreneurs "shopkeepers", while in developed countries there were more innovative entrepreneurs and a higher presence of large firms that might complement the small ones (Van Stel *et al.*, 2005).

Minniti and Lévesque (2010) suggest that entrepreneurial activity may take the form of either imitative or research-based labour and that the presence of a sufficient amount of either type of entrepreneurship has a positive effect on the growth pattern of the economy. They added that when the cost of innovation is high, a country can experience economic growth by focusing on imitation such as the case of China, where 'imitative' entrepreneurs mobilise abundant resources (low wage labour) to create growth. However, this might not be the case in other developing countries with low wage labour since they lack 'appropriate political institutions' and thus hinders entrepreneurial initiatives. On the other hand in the case of low growth in Japan and Sweden, it signals a low level of entrepreneurial activity as large amount of labour employed in R&D does not guarantee an economic benefit as it depends on how much of this R&D is actually commercialised (*op cit.*).

Acs and Virgill (2010), identified network, knowledge, failure and demonstration as externalities affecting entrepreneurship in developing countries. They argued that economies that work positively with those externalities would produce greater level of entrepreneurship. Networks are both local, such as domestic associations, or international, industry clusters and links to international clusters. *"Networks are extremely important in developing countries in ways which go beyond the traditional network externalities of connecting firms with information on suppliers, markets, and production techniques"* (Acs and Virgill, 2010: p. 45-46). Regarding knowledge, they argued that knowledge causes productivity improvements and promotes economic growth, and since knowledge and education are problematic in developing countries they tend to go to known industries rather than new ones. Knowledge and information on what to produce and how to produce are impacted by information asymmetries, transaction costs, education levels, research and development opportunities and foreign direct investment (FDI) and thus hampered by high discovery costs in developing countries. This might partially explain the low level of innovativeness in developing countries and challenges that face them. Regarding demonstration and failure externalities, it is learning by watching success and failure, which are affected by 1) culture value and norms; 2) views of outsiders and inclusiveness; 3) the level of economic freedom; 4) economy's fundamentals including macroeconomic stability, infrastructure, and level of development of its financial markets.

2.2.3 Entrepreneurship and Job Creation

Growth of the small firm contributes to economic development, and as owners expand their businesses in terms of profitability and sales turnover, employment generation occurs as a consequence (Smallbone and Wyner, 2006). According to Fritsch (2013), the effects of new business formation on regional development would include creation and destruction of employment, introduction of innovations, structural change, and increasing productivity, among other factors causing a diverse indirect effect on development and thus becomes much more important than the growth effects of newcomers. Reynolds' (2012) study suggests that in countries with access to informal finance and emphasis on traditional rather than secular and self-expressive values are more likely to find business opportunities and are confident of their capability to start their own business. Formal institutions have very modest relation with business creation, while informal institutions such as established culture and value systems have considerable influence (*op cit*.).

New businesses formations do create employment, however their direct contribution to overall employment is relatively small; they have indirect effects that can take up to 10 years to manifest and hence indirect employment tends to be much larger than direct (Fritsch, 2013). Van Praag and Versloot (2008) argued that high technology firms have a relatively higher employment creation, productivity growth, and innovation; moreover, all entrepreneurial firms have a long run spillover that affects regional employment growth. Concentrating on high growth alone such as 'gazelles' might not be sufficient for job creation, although it's easier from a public policy dimension than supporting hundreds of thousands of small enterprises (Reynolds, 2012). The concept of 'Gazelles' was first introduced by Birch (1979, 1981, 1987) in which he claims that new businesses are the main job creators in the US between 1969 and 1976 demonstrating that two thirds of increase in employment was in small firms with 20 or less employees, and a few fast growing 'Gazelles' are responsible for the majority of those jobs arguing that 4 percent accounted for 70 percent of new jobs between 1988 and 1992 (Birch and Medoff, 1994). This argument did not stand in all cases, when taking into consideration overall job growth in a certain sector, for example Wal-Mart created 2 million jobs in 50 years but the overall retail market net jobs did not increase (Reynolds, 2012). It was found important for the outcome of this research to realise the role of 'gazelles' and HGEs in job creation, moreover to differentiate SMEs and HGEs when it comes to policy recommendations. It is important to understand the literature concerned with this concept to recognise the debate around entrepreneurship and job creation and how HGEs, as the main job creator, could be funded by providing a vibrant VC industry.

2.2.4 Entrepreneurship and Role of Government

The government role in entrepreneurship policy is mostly through institutional development to enhance and promote entrepreneurship. According to Busenitz, Gomez, and Spencer (2000), an institutional perspective taking into consideration regulatory, cognitive, and normative accounts was found beneficial to evaluate country differences on the level of entrepreneurship development and type of entrepreneurs. The role of government in entrepreneurship policy is important; however, what kind of role to play varies across countries and there is no one policy that fits all (Minniti, 2008). In a study by Manolova, Eunni, and Gyoshev (2008) on entrepreneurship in emerging economies in Eastern Europe, they found significant differences in the three institutional dimensions of regulatory, cognitive, and normative, reflecting distinctive cultural norms and values, traditions, and institutional characteristics in promoting entrepreneurship. Thus cultural aspects where found important for determining the role of government. McMullen, Bagby, and Palich (2008), argued that governmental restrictions affecting economic freedom would affect entrepreneurial activities in different countries; however, they found differences among opportunity motivated versus necessity motivated entrepreneurs where property rights was positively related with the former, while fiscal and monetary freedom was positively related with the later.

Anokhin and Schulze (2009) suggest that corruption and the quality of a nation's institutions are important factors affecting rates of entrepreneurship and innovation across countries. Bennett (2006), identified three main dimensions for the governments' role to assist and promote SMEs; a regulator, economic agent, and strategic planner and promoter.

2.2.5 Summary

Entrepreneurship and SMEs, though not the same, are both important to countries' economic growth (Thurik and Wennekers, 2004). Researchers suggest that there is a positive relationship between entrepreneurship and economic growth (Audretsch, 2002; Carree *et al.*, 2002). Economic development requires change and entrepreneurs are the agents of that change (Acs and Virgill, 2010). New business formation creates employment (Birsch, 1987), yet more evidently on the long run (Fritsch, 2013). High growth, high potential ventures (HGEs) are argued to have more significance in job creation and innovation leading to economic growth (Timmons and Spinelli, 2003; Van Praag and Versloot, 2008). Accordingly, governments act to promote entrepreneurship and SMEs (Minniti, 2008); among the roles that governments can assist and promote SMEs is addressing lack of capital (Bennett, 2006). According to previous discussions, this research argues that HGEs are of significant value to the Egyptian economy and a valuable contributor to innovation, economic growth and job creation. Furthermore, access to finance could be a key issue hindering the development of HGEs in Egypt, particularly with the challenging entrepreneurial finance scene and specifically the venture capital industry.

It should be well noted that there is an increasing set of literature dealing with ethical implications, dilemmas, and moral issues regarding entrepreneurship (Hannafey, 2003). *"The numerous cases of unethical practices reported from entrepreneurs' personal experiences illustrate various forms of unethical attitudes by entrepreneurs and managers, in a range of management fields: marketing, negotiation, personnel management, supplier–customer relations, government relations. Dubious practices include lies and deception, breaches of promise, passive corruption, unfair competition, personal advantages for management and the* *manipulation of communication."* (Fassin, 2005: P. 266). Furthermore, Anderson and Smith (2007) researched the moral space in entrepreneurship exploring ethical imperatives and the moral legitimacy of being an entrepreneur. Also Morris, Schindehutte, Walton and Allen (2002) explored the ethical context of entrepreneurship. This set of research suggests that further investigation on entrepreneurship and ethics needs to be addressed alongside the economic benefits of entrepreneurship. This thesis is concerned with literature on entrepreneurship in general and entrepreneurial finance in particular, however, it was found important to acknowledge the debates on ethical implications on entrepreneurship. The second section of this literature review elaborates on the topics of entrepreneurial finance literature, both internal and external finance and whether debt or equity.

2.3 SMEs and Access to Finance

Although there is a robust correlation between SMEs and economic growth, yet there is no causal impact of SMEs on GDP per capita growth (Beck and Demirguc-Kunt, 2006). This lack of empirical causality might be partially a result of constraints facing SME growth, and access to finance would be counted as one of those constraints. Accordingly the topic of SMEs access to external finance became of high importance to both academics and policy makers in both developed and developing countries (Berger and Udell, 2006). It is widely believed that SMEs face higher constraints to access external finance than large corporations (Beck and Demirguc-Kunt, 2006). Moreover, the growth potential of small firms was found to be limited by scarce access to external finance (Becchetti and Trovato, 2002), and thus holds back innovation and growth (Hyytinen and Toivanen, 2005). Small firms are in many ways different than large quoted firms where the later have access to capital markets and a clear separation of ownership and management structure (Jarvis, 2006). Consequently, such differences generally lead to information opacity, where the owner/manager is not obliged to run systematic bookkeeping or disclose financial data. In fact, information opacity is argued to be a key feature that differentiates SMEs from large corporations; the former are not listed to access public market, contracts are not publicly visible to press, and many have no audited financial statements (Berger and Udell, 1998). Such information opacity creates a state of ‘information asymmetry’ between the business owner and financiers causing a ‘moral hazard’ and increasing the risk of non-repayment. Besides information asymmetries, lack of collaterals and weak cash flows are all challenges that face small businesses to raise external finance (Berger and Udell, 1998). As a result, theory of financial intermediation elucidates the role of financial intermediaries to facilitate overcoming small firms’ opacity (*op cit*.).

Improving financial systems would support entrepreneurial activities and enhance the probability of successful innovation and thus accelerate economic growth (King and Levine, 1993). Lack of financial and institutional development hinders SMEs access to finance and thus believed to be a major constraint to their growth; nevertheless financial tools such as leasing, factoring, systems of credit information, and competitive banking structure might help in mitigating this problem albeit absence of well-developed institutions (Beck and Demirguc-Kunt, 2006).

2.4 Entrepreneurial Finance and Finance Gap

In a paper providing an overview on issues regarding entrepreneurial finance, Denis (2004: p.303) identified four 'primary areas' of research: alternative sources of capital, financial contracting issues, public policies and risk and returns of investments. Elaborating on alternative sources of capital, Denis pointed out three 'primary sources' for financing entrepreneurs, VC funds, angel investors and corporate venture investors, arguing that VCs provides several benefits to the entrepreneur; however, they remain an expensive source of capital. According to Vinturella and Erickson (2004) "Entrepreneurial ventures can be defined as new business start-ups with high growth aspirations." Contrary to corporate finance the goals of the business and the entrepreneurs are intertwined. Financing comes from two basic sources: debt and ownership equity; self-finance, bootstrapping, friends and family, customers and suppliers, leasing, barter. The seed capital of the vast majority of entrepreneurial finance is a combination of personal investments of the owners of the venture with equity and from family and friends; external financing is mostly through private equity and debt rather than public markets (Berger and Udell, 1998).

At the point when profitable opportunities arise beyond firms' internal financial capacity; there emerges what is known as a 'finance gap' where firms would need external finance to grow (Jarvis, 2006). From another perspective, a study by Vos, Yeh, Carter, and Tagg (2007) indicated that SMEs in the UK and US shows a significant level of financial content and very few (less than 10% in UK and 1.32% in US) signalled shortage of capital (other than working capital). Furthermore, older firms with more educated owners were found less likely to seek external finance (Vos *et al*., 2007). According to Javis (2006), the financing gap hypothesis stems from as early as 1931 by Macmillan *et al.* and is argued by some scholars (e.g. Deakins, 1996) to be, if still exists, considerably narrowed due to market reactions and public policies while this claim is disputed by others (e.g. Harrison and Masson, 1995). As this might be the case in developed economies, a finance gap still persevered to exist in developing economies.

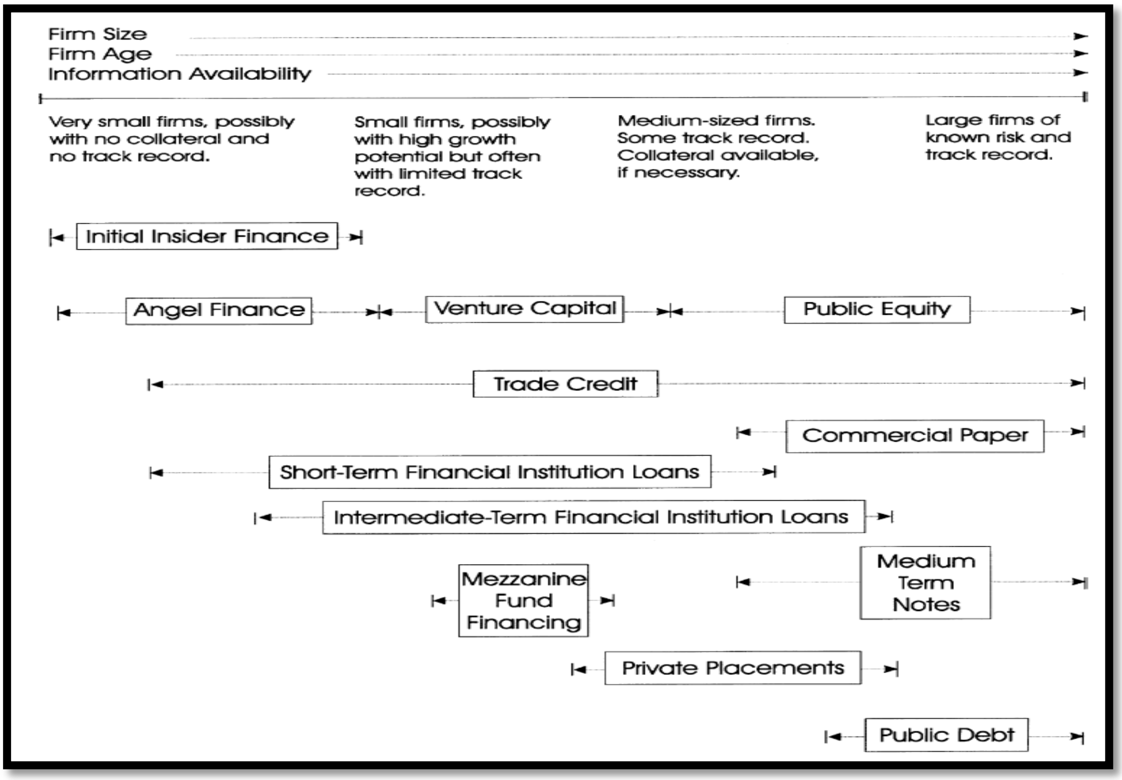
The main challenges remain; risk, information asymmetry, and moral hazard. It varies according to the organisational form, type of business, and degree of control; the amount required, shareholders preference and legal issues. The problems of equity and debt financing and information asymmetries are believed by several financial economists to be eliminated by financial intermediaries such as VC firms (Lerner, 1998). To overcome the information problem venture capital would get involved with planning and operations of the small firm and thus the entrepreneur would forego some of his control; on the other hand banks would use collaterals, contracts and covenants while the entrepreneur would remain in full control over the firm's operation (Berger and Udell, 1998). According to Rosen (1998), group of theories on entrepreneurial finance would focus on financial constraints, while others focus on capital structure and portfolio aspects, another group would focus on information problem. Various theories suggest that entrepreneurial finance is not a static state; it changes over time and preference of internal and external sources of funding (Rosen, 1998). Entrepreneurial finance can take the form of debt and/or equity financing, however it is apparent that the source of external finance is highly dependent on the type, age, and preference of the entrepreneurial venture. The coming section (2.5) elaborates on the capital structure, followed by a dedicated section on debt financing (2.6) and bootstrapping (section 2.7), and then equity financing is elaborated in thorough details (section 2.8).

2.5 Capital Structure

According to Myers and Majluf (1984), the presence of information asymmetries would lead firms to acquire equity at a higher cost than debt. They argued for what is known as a ‘Pecking order theory’ of capital structure that firms would prefer internal finance over debt, short-term debt over long-term debt, and all debt over external equity. Before reaching the financial gap, most firms would fully exploit their internal resources before seeking either debt or equity in a manner argued to comply with the notion of pecking order. The capital structure of small firms and preference of its owners were thoroughly researched and that debt was best utilised after exploiting internal finance was well established (Berger and Udell, 1998). Hamilton and Fox (1998) argued that small firms’ choice between debt and equity were not properly understood and had unrealistic expectations of new equity deals. They suggested that the funding gap is a ‘consequence rather than the cause’ of the small firm’s financing decisions. Norton (1991) suggests that contrary to financial theory, bankruptcy costs, agency costs, and information asymmetries play little role, if any, in affecting capital structure policy; rather, small firms would follow a pecking order in regard to its capital structure while concerned with market conditions and personal preference.

Information opacity is argued to be a key feature that differentiates SMEs from large corporations (Berger and Udell, 1998). It is generally perceived that the opacity of SMEs causes the banks to neglect this sector, on the contrary, De la Torre, Martinez Peria, and Schmukler (2010) found that SME sector is a strategic group for all types of banks and would expand in serving them. In their study of 12 developed and developing countries, they found that banks developed new business models to serve SMEs where lending is one of many services. However, they argued that start-ups and hi-tech companies might still have to resort to alternative non-banking routes of financing. Hence high growth-high risk ventures with intangible assets more often attain equity financing, while low growth-low risk ventures with tangible assets are more likely to acquire debt financing (Berger and Udell, 1998). The decision on using capital, whether debt or equity, was found to affect the performance, risk of failure, operations, and growth opportunities of start-ups (Cassar, 2004). The source of capital and the capital structure of small firms would vary according to the size and age of the firm (Berger and Udell, 1998). Entrepreneurs were found in favour of debt in the form of bank finance to sustain their full control over the venture; however in the case when VC productivity was higher than entrepreneurial productivity, equity in form of VC was preferred over bank finance (De Bettignies and Brander, 2007). Figure (2.1) shows how different sources of financing fit to the age and size of different venture.

Figure (2.1) Firm Continuum and Sources of Finance



Source: Berger and Udell (1998)

2.6 Debt Financing

Private debt financing is sourced from different alternatives; financial institutions, non-financial, government, and individuals (Berger and Udell, 1998). Non-financial debt is in the form of trade credits from suppliers and government guarantees; individuals are friends and family or credit cards; and financial institutions would be banks and other institutions. However, many new firms and start-ups find it difficult to raise debt financing due to lack of collaterals, unstable cash flows, and opacity (Berger and Udell, 1998). Sources of finance, other than equity, for the small business could be banks, loan guarantee schemes, leasing and hire purchase, and factoring (Jarvis, 2006). In fact, leasing is an important financial tool for SMEs when supported by credit guarantee schemes (Kraemer-Eis and Lang, 2012). Collaterals and guarantees play an important role in small firms' lending to overcome the moral hazard that might take place after lending (Berger and Udell, 1998).

Berger and Udell (2006) developed a conceptual framework for SME financing. They argued that there is a causal chain that starts with government policies influencing market shares and competitiveness of financial institutions among regulatory environment and ends with the availability of alternative SME lending technologies represented in financial statement lending, small business credit scoring, asset-based lending, factoring, fixed asset lending, leasing, relationship lending, and trade credit. *"The choice of lending technology for a specific creditworthy SME depends on the sources of information available for that firm, as well as the adaptability and appropriateness of the various screening, underwriting, contracting, and monitoring techniques dealing with the firm in its environment"* (Berger and Udell, 2006: p. 2962).

Smaller and younger firms that are most likely still owned by their founders are more constrained to receive bank financing (Levenson and Willard, 2000). The larger the start-up, the larger is the proportion of debt and reliance on banking finance (Cassar, 2004). Moreover, banking finance is positively related with the presence of tangible assets, and thus lack of tangible assets would lead firms to seek informal and non-banking sources of finance which is found consistent with agency cost found in start-ups (Cassar, 2004). In the US it was found that over half of the small businesses sample would use bank finance in the form of lines of credit while the second largest usage was mortgage finance at 13.89% (Berger and Udell, 1998). Moreover, over 50% of bank credits were personally guaranteed by the business owners (*op cit*.). They can take the form of internal or external collateral assets, or in the form of inventory and accounts receivables. Loan commitment contracts and debt covenants were other methods used to mitigate the banks' risk in SME lending. Relationship lending is another concept where the financial institution (usually banks) relies on detailed information on entrepreneurs and credit history over a relatively long period of time (*op cit*.).

2.7 Bootstrapping

Before resorting to external debt or equity financing, entrepreneurs would most often opt to bootstrapping. Bootstrapping techniques are widely and strategically used by entrepreneurs and has been an important topic of study in entrepreneurial finance (Bhidé, 1992; Freear, Sohl, and Wetzel, 1995; Winborg and Landstrom, 2001; Ebben and Johnson, 2006; Lam 2010). Bootstrapping is defined as a collection of methods used to minimize the amount of outside debt and equity financing needed from banks and investors (Winborg and Landstrom, 2001). Some of these methods would include reducing overall capital requirements, improving cash flow, and taking advantage of personal sources of financing (Ebben and Johnson, 2006). Bhide (1992) criticised entrepreneurs for spending a lot of time to seek large funds from venture capital firms; instead of concentrating on taking off their ventures. He emphasised on the benefits of bootstrapping over venture capital. VC firms require solid business plans, track records, and well defined markets, while entrepreneurs strive on energy and enthusiasm which could be hampered by VC requirements. Winborg and Landstrom (2001: p.243-244) identified six main methods used in bootstrapping. (1) "Owner financing methods" by direct or indirect provision of resources from the (owner) manager and relatives; (2) "minimisation of accounts receivable" by speeding up invoicing or using interest on overdue payment; (3) "joint utilisation" by sharing and borrowing resources from other businesses; (4) "delaying payment" such as delaying payments to suppliers and leasing equipment; (5) "minimization of capital invested in stock" by using formal routines to minimise the amount of capital invested in stock ; and (6) "subsidy finance" by obtaining subsidies from public organizations. Ebben and Johnson (2006) indicated that firms would use different types and levels of bootstrapping over time.

2.8 Equity Financing

Entrepreneurs at some point would need external finance to scale their business beyond their personal capital. From previous discussions over capital structure and availability of debt finance, smaller firms with lack of collaterals, intangible assets, high risk, and most probably in the high technology sector seeking external finance would resort for equity. Whether it is a personal preference or the only available option is explored in this section as well as the available tools of equity finance and when and why they are chosen. The most common sources of external equity finance are the informal angel financing and the formal institutionalised venture capital (Berger and udell, 1998). The reason that high-growth, high-risk new ventures often obtain angel finance and/or venture capital before they obtain significant amounts of external debt finance suggests that the moral hazard problem may be particularly acute for these firms (Berger and Udell 1998). Regarding preference on when to raise external equity, Schwienbacher (2007) suggests that some entrepreneurs would invest their own money then seeks finance from a venture capitalist (Just-do-it strategy), and others would seek external finance before they invest their own money (wait-and-see strategy). It was found that in the more profitable ventures, entrepreneurs would rather invest their own money before seeking venture capital, and they would rather seek angel investors before venture capital to maximise their profits (Schwienbacher, 2007). Although one of the major constraints for SME finance is to access public markets (Berger and Udell, 2006); many countries such as the UK, introduced secondary stock exchange for the small and growing firms to raise equity (Alternative Investment Market (AIM)). However, the conditions for listing and the cost of listing made ‘very little contribution’ to small firms in the case of AIM in the UK (Jarvis, 2006: p.349). This research acknowledges the contribution of secondary stock exchange markets to the development of SMEs and entrepreneurial finance ecosystem. However, the literature on the significance and effect of secondary markets on entrepreneurial ventures is beyond the scope of this work. This thesis explores entrepreneurial finance with an intentional focus on start-up financing and the alternative sources of funding. In other words, angel investments, the newly developed crowdfunding platforms, and a larger emphasis on the venture capital industry are of a primary focal point to this research. The coming sections will start with angel investors followed by crowdfunding and finally venture capital as means of equity for entrepreneurial ventures.

2.8.1 Angel Investors

Angel financing might be the oldest form of funding in the history of economic activities through high net worth individuals (HNWIs) and wealthy families; however recently in 1990s angel investors started forming groups and collectively finance entrepreneurial ventures (Kerr, Lerner, and Schoar, 2014). The definition of business angels by Mason (2006: p.363) is "*high net worth individuals who invest their own money, along with their time and expertise, directly in unquoted companies in which they have no family connection, in the hope of financial gain*."

It is believed that many promising firms fail to raise finance from venture capital firms; moreover, venture capital firms tend to concentrate their investments in certain regions and industries, accentuating the value of angel investors (Lerner, 1998). Angel financing is greater in number of transactions and value of investments than venture capital worldwide (Fairchild, 2011). Angel investments are considered an "informal venture capital market", where angel investors finance whether their circle of family and friends (family funding or love money) or complete strangers (Business Angels)

(Mason, 2007). The profile of a business angel worldwide (except Japan) was found to be over 95% male, between 46 and 65 years of age, successful cash out entrepreneurs, and well educated (Mason, 2007). Business Angels would fill the equity gap before seeking venture capital; as venture capital deals are relatively larger to cover the transaction costs, they tend to overlook the smaller deals that might still be feasible to business angels (Schwienbacher, 2007). The investment process of business angels is similar to the venture capital (detailed in section 2.8.3), however less sophisticated; in addition, venture capital and business angels have a complementary relationship in serving entrepreneurial finance (Mason, 2007). Although venture capital firms have greater business capabilities than angel investors, entrepreneurs might prefer angel investors due to the level of entrepreneur-angel empathy and trust relationship that help overcoming moral hazards (Fairchild, 2011). The hands-on management of business angels is an important value adding factor considering their expertise, knowledge, and experience; ranging from informal coaching to board representation, angels are most likely to invest in industries of their interest and familiarity (Mason, 2007). In addition, a strong positive relation was found between angel funding and start-ups' success and survival rate (Kerr *et al*., 2014). Furthermore, Kerr *et al*. (2014) suggest that there is other significant value adding activities of angel investors rather than pure financial input. Ventures funded by angel groups were found to outperform rejected ventures regarding survival, exits, employment, patenting, Web traffic, and financing (Kerr *et al*., 2014). It is very difficult to assess the amount of investments of informal capital market, since angels are willing to stay anonymous and they are not obliged otherwise, yet the invested amounts remain very significant (Mason, 2007).

2.8.2 Crowd funding

Most recently, entrepreneurs started raising direct capital from the public "crowd" using internet platforms to cover their financial needs, what is now known as "crowd funding" (Schwienbacher and Larralde 2010). According to Belleflamme, Lambert, and Schwienbacher (2013; p.4) crowdfunding could be described as *"an open call, essentially through the Internet, for the provision of financial resources either in form of donation or in exchange for some form of reward and/or voting rights in order to support initiatives for specific purposes"*. The concept evolved around the emergence of "Crowd Sourcing" (Kleemann, Voss, and Rieder, 2008) where the crowd contributes to the development, design, or any value creation to a venture (Schwienbacher and Larralde 2010). The phenomenon of "crowdsourcing" was made possible with the technological innovation of "Web 2.0"; where customers-firm relationship evolved to a concept of "working consumer" (Kleemann *et al*., 2008).

Lambert and Schwienbacher (2010) found that that crowdfunding market was very young (3-4 years prior to their study) with about 60% taking place in Anglo-Saxon countries. The concept started with artists and movie makers which then included ICT, sport, journalism and more. Crowdfunding is sometimes based on donations, however almost 80% would get some sort of reward including shares, cash payments, or a personalised free copy of the products. The median of the required capital is approximately 100,000 Euros, yet the median raised was about 28,500 Euros (*op cit*.). According to a NESTA report (a UK charity innovation foundation), more than 2.7 billion USD was raised through crowdfunding globally in 2012; in the UK alone 200 million GBP were invested through crowdfunding (Baeck and Collins, 2013).

The option of crowdfunding is generally used by entrepreneurs for several reasons. First, for pure financial reasons, i.e. other options are unavailable or are lower than venture capital and business angel appetite. Second, for reducing cost of capital that might reach a form of donation from the public. And finally, to create “hype” in the internet world and social networks thus creating exposure to greater audience and test demand (Lambert and Schwienbacher, 2010). On the other hand, crowdfunding participants would participate for the joy and fun of contribution in addition to financial rewards (Schwienbacher and Larralde 2010). Moreover, consumers feel they are part of product success (desire of patronage), part of communal social initiative (desire of for social participation), as well as financial payoff (desire for investment) (Ordanini *et al*., 2011). Belleflamme *et al*. (2013) identified two types of crowd funding; a pre-order the product type and the share for profit equity type. They argued that crowdfunding could be considered a form of bootstrapping, especially when it is in the form of pre-ordering the products and using the money as a working capital.

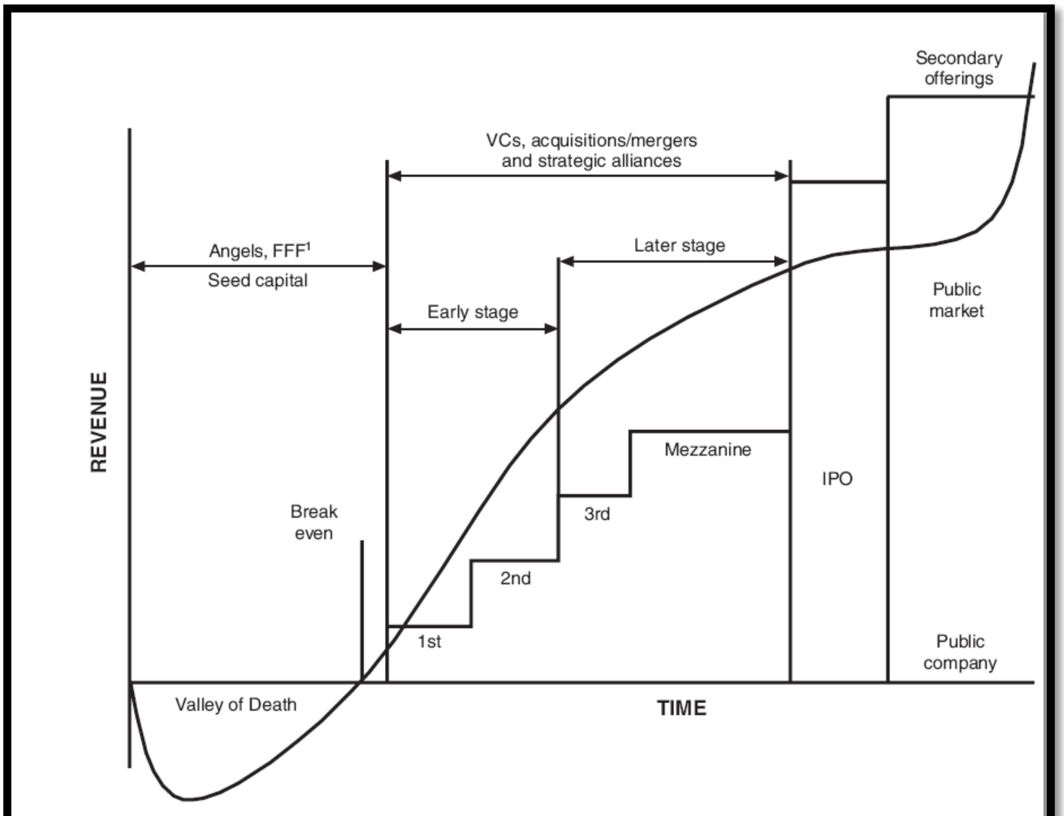
Many of the internet economic activities are considered much less geographically dependent; it was found that in crowdfunding this was also true, yet the role of proximity was still evident (Agrawal, Catalini, and Goldfarb, 2010). In a different study by Agrawal *et al*. (2011) on artists seeking crowdfunding, they found that the average distance between artists and funders was 3000 miles, signalling a reduced role of spatial proximity, however, distance still plays a role most visible in family and friends investing in the same projects.

2.8.3 Venture Capital

There is no strict definition of venture capital firms; however, the simplest would be as "risk equity investing" (Gompers and Lerner, 1999). Amit, Brander and Zott defined a venture capital as a provider of capital to privately held entrepreneurial firms with equity, debt or hybrid financing accompanied by managerial assistance (1998). There are corporate venture capital and independent venture capital (Chesbrough, 2002). This research will adopt the ‘broader’ definition of VC which includes early-stage independent classical VC and late-stage capital commonly regarded as PE while focusing in the analysis on the former which is the independent classical VC model financing start-ups and early stage enterprises while providing them with managerial and technical assistance.

Several studies have used this ‘broad’ definition and included MBO/MBI (Management Buy-ins and Management Buy-outs) and PE activities in their research. This occurs more often in Europe, (Wright and Robbie, 1998; Karsai, Dudzinski, and Morovic, 1998; Megginson, 2004; Wright *et al*, 2005b), and in Asia whereas PE is the more predominant investment (Bruton, Ahlstrom and Singh, 2002; Bruton, Ahlstrom and Yeh, 2004). Indeed, there is no conflict between this definition and the one adopted by the study of Gompers and Lerner (2001: p.146), *“We will focus here on venture capital, defined as independent, professionally managed, dedicated pools of capital that focus on equity or equity-linked investments in privately held, high growth companies”*. In support of this ‘broad’ definition, the VC including PE investments definition is commonly used in most of VC/PE associations worldwide. Another reason for adopting the broader definition in this research is the fact that all the reports and hence all the data addressing venture capital whether via local or international agencies deal with PE and VC collectively and interchangeably, especially for what concerns the MENA region whereas classical VC hardly exists compared to PE. Fig. (2.2) clarifies the fitness of VC in regards of financing lifecycle.

Figure (2.2): Financing lifecycle



1. FFF stands for "family, friends and fools".

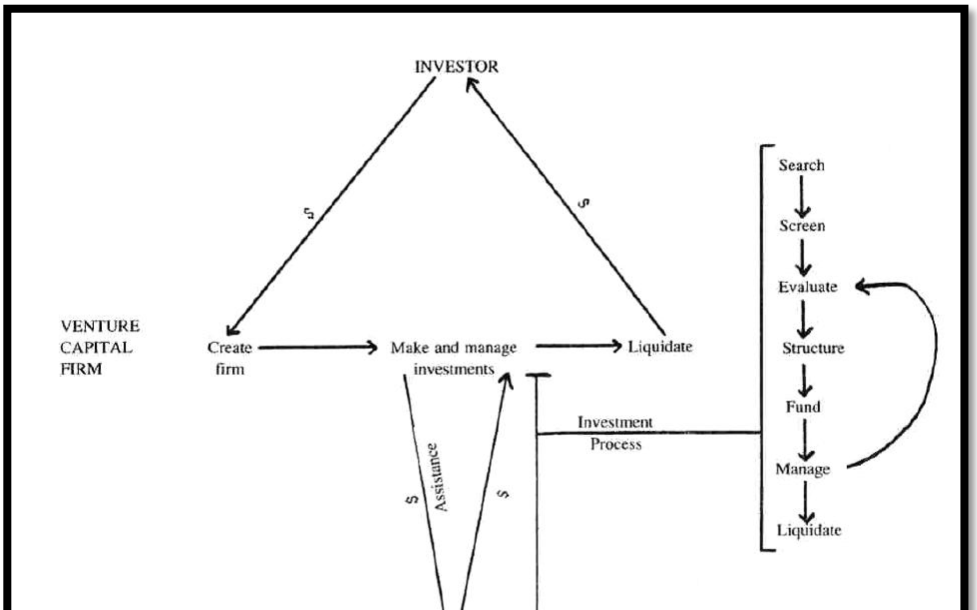
Source: Cadullo (1999)

The origin of the VC industry emerged in the USA with the first 'true' VC firm in 1946, where Karl Compton (MIT president) and General George F.Doriot (professor at Harvard Business School) formed ' The American Research and Development' (ARD) (Gomper and Lerner, 2001). The golden era of the VC in the US of the 80s and 90s started with the wave of dot coms and IT enterprises. Many high technology firms have received VC funding such as Apple computers, Intel, Microsoft, Cisco systems and others, other industries in service sectors includes Starbucks, TCBY and Federal Express have also been among the VC funded firms (Gompers and Lerner, 2001).Following the same steps of North America, the UK witnessed early trials in 1945 (BVCA, 2005). According to Murray (1995) the UK VC industry, as we know it today, started in the late seventies and the early eighties to displace banks and financial houses in the investment of young and unquoted companies.

Regarding the '*raison d'être*' of the VC industry, Amit, Brander and Zott (1998) argued that the industry emerged by developing capabilities whereas the venture capital firms are able to overcome 'hidden information' and 'moral hazard'. The hurdle of 'hidden information' was often encountered by the tendency of the investee to hide important information to oversell his project and 'moral hazard' when an entrepreneur might have a plan to take the money and run (Amit *et al.*, 1998). Similarly, Gompers and Lerner (2001) stated that VC firms can overcome this information gap by rigorous tools that 'scrutinise' the investees before funding and monitoring them afterwards. According to Dennis (2004) the major difference between VC as an alternative source of funding and conventional sources of finance, is the magnitude of the agency problem and asymmetry problem, exemplifying the differences between entrepreneurial financing and corporate financing. He added that this is the reason that the most commonly used theories to explain the VC industry are agency theory and information asymmetries. Examples for using agency theory in studying VC industries are the work by Sahlman (1990) on Investors-VC and VC-Entrepreneurs relations and governance, and the research by Norton (1996) on the concept of capital allocation and the role of agency cost. Norton (1996) suggested that many problems are associated with capital allocation decisions by VC firms. Cumming (2005) explored the effect of agency cost among other factors on contracting issues in VC in the US and Canada. Further on VC-entrepreneur relationship perspective, Cable and Shane (1997) used a prisoner's dilemma framework to analyse this relationship.

Understanding the nature of the VC firms, the way their business is done, and their investment cycle is essential to efficiently analyse the industry and its behaviour. According to Dennis (2004), main activities of VC firms are 'monitoring' as in mentoring, strategic advice and directorship, 'Professionalization' in business planning and human resource policies, and 'certification' of the start-up quality. Gompers and Lerner (2001) believed that comprehending the 'venture cycle' is an integral part to understand the VC industry. They summarised it as *"raising a venture fund; proceeds through the investment in, monitoring of, and adding value to firms; continues as the VC firm exits successful deals and return capital to its investors; and renew itself with the venture capitalist raising additional funds"* (p.152). Fried and Hisrich (1988) in Figure (2.3) exhibit the VC process illustrating the relationships of investors-VCs-investee as well as the investment process of VC firms.

Figure (2.3): The Venture Capital process

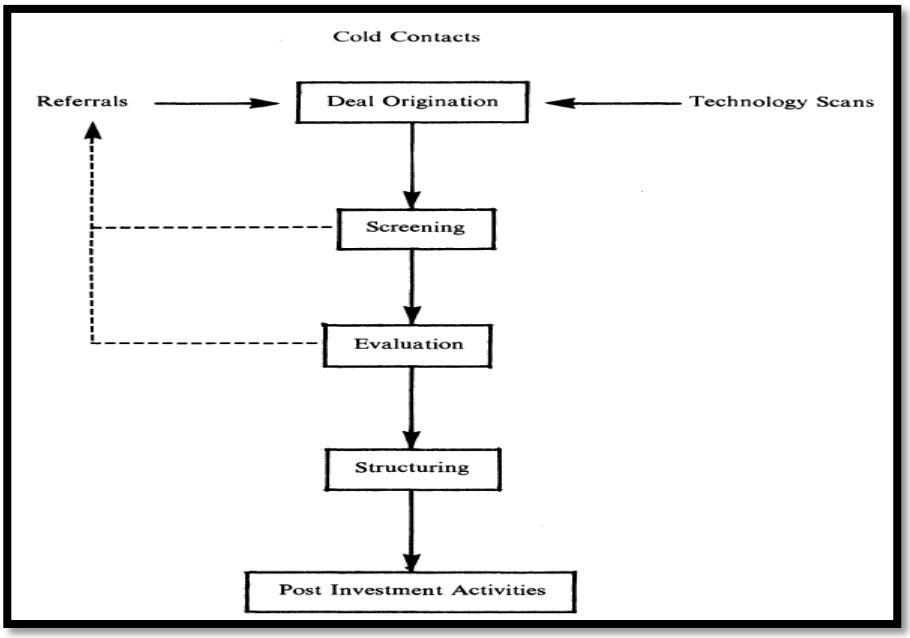


Source: Fried and Hisrich (1988)

The literature concerned with the dimension of the VC firms' operations is reflected in the analysis of their decisions throughout their business cycle. Thus, it can be better comprehended by following the venture cycle illustrated by Gompers and Lerner (2001), fundraising, investment, monitoring, value-adding, and exiting. Fundraising decisions start with the legal setup of the company, establishing the fund and the fund management company whether onshore or offshore or a combination of both depending on regulatory and capital gain taxing policies. At the same time the VCs identify the main strategy of the fund whether generalist or specialist and the investment criteria (size and stage) of the portfolio of companies. Afterwards, it materializes in the actual fundraising (Gompers and Lerner, 1998) where capital gains tax and interest rates are among the factors that affect the inflow of capital (Gompers and Lerner, 2001). Berger and Udell (1998); Gompers and Lerner (1997) suggest that when the stock market is slow and IPO shuts down this may reduce the flow for angel investment and VC funds and when the market is high it increases the rush towards VC funds and angel investments.

The investment process can be expanded by using the Tyebjee and Bruno model (1984) showed in figure (2.4) to deal origination, screening, valuation (Manigart *et al.*, 1997), structuring and using contracting methods (Cumming, 2005; 2006). There are the investment strategies (Dimov and De Clercq, 2006; Mangiart *et al.*, 2002; 2006), selection criteria of the investee companies (Wright and Robbie, 1996), and the concept of syndication which are quite common among developed VC markets (Lockett *et al.*, 2006). Brander, Amit and Antwieler (2002) tested two possible reasons for syndication which were informative second opinion and complimentary additional VCs' management skills. They have used an empirical analysis from datasets of the Canadian VC industry and their findings favoured the managerial value-adding activities over informative selection reasons.

Figure (2.4): Venture capitalist investment activity



Source: Tyebjee and Bruno (1984)

Finally, are the post-investment activities, which are the fifth and last of the Tyebjee and Bruno model (1984) and include the monitoring, value-adding, and exiting practices as indicated by Gompers and Lerner (2001) VCs cycle. On monitoring there is the work by Steier and Greenwood (1995), and the research on management strategies whether hands-off or hands-on and sector specialisation whether high-tech or low-tech (Jungwirth and Moog, 2004), governance (Sahlman, 1990); the amount of time dedicated (Jaaskelainen, Maula and Seppa, 2006). Then there is the value-added activities towards their portfolio of companies (Gorman and Sahlman, 1989) how closely they monitor the CEOs or entrepreneurs (Macmillan, Kulow and Khoylian, 1989) and how they overcome times of difficulty (Higashide and Birley, 2002). Disagreements are found beneficial while personal friction declined performance. From a different perspective, importance of networks as another value-added activity was empirically analysed by Hochberg, Ljungqvist, and Lu (2007) to test the relationship of networking and fund performance in the US VC market and figured that better networked VC firms encompass significantly better performing funds. Finally, there is the stage of Exit and the strategies preferred and exercised among VC firms (Lange *et al*., 2001; Doukas and Gonenc, 2005).

The following highlights on the foundation work on the US VC industry will operate as the benchmark in the analysis of the industry in Egypt. First is the previously mentioned model of venture capitalist investment activities by Tyebjee and Bruno (1984) which consists of five sequential steps; 1) Deal origination, 2) Deal Screening, 3) Deal Evaluation, 4) Deal Structuring, and 5) Post Investment Activities. In addition, they categorised the selection criteria to five main factors; 1) Market Attractiveness, 2) Product Differentiation, 3) Managerial capabilities, 4) Environmental Threat Resistance, and 5) Cash Out potential.

Second is the work by Gorman and Sahlman (1989) on what do venture capitalists do and the relationship between VCs and the portfolio companies by which they have identified six main forms of VCs assistance to their portfolio companies; 1) help obtaining additional financing, 2) Strategic planning, 3) Management recruitment, 4) operational planning, 5) Introductions to potential customers and suppliers, 6) Resolve compensation issues.

Third is the research by Macmillan, Kulow and Khoylian (1989) on the VCs involvement in their investments which grouped VCs' involvement to three main groups; *laissez-faire* involvement, moderate involvement and close tracker involvement. They identified the activities with most VC involvement as follows: serving as sounding board to entrepreneur team, obtaining alternative source to equity financing, interfacing with investor group, monitoring financial performance, monitoring operating performance, and obtaining alternative sources of debt financing. On the other hand, the activities with least VC involvement were identified as follows: selecting vendors and equipment, developing production or service technique, developing actual product or service, soliciting customers or distributers, testing or evaluating marketing plans, and formulating marketing plans. The classical VC model in developed markets, namely the US, emerges from the combination of the former literature specially the work of Tyebjee and Bruno (1984), Gorman and Sahlman (1989) and the work of MacMillan *et al*. (1989) which this study will use as the points of reference.

The Venture capital industry is growing tremendously worldwide, and this growth is taking an international dimension in both growing indigenous VC markets copying the US and other successful VC industries' model (Wright, Pruthi, and Locket, 2005b; Bruton, Fried, and Manigart, 2005), or in the form of VC firms crossing borders and expanding their activities in foreign countries where opportunities exist (Wright *et al.*, 2005b). A good deal of research has shown that there are differences in the development of VC industries due to different environments in different countries in addition to differences in the behaviour of the VC firms among different countries and regions (Ooghe, Manigart, and Fassin, 1991; Bruton *et al.*, 2005). In their paper on VC development in Europe, Ooghe *et al.* (1991) stressed on the differences between European US VC industries, they also mentioned that even among European countries there are many differences due to different structures, institutions and policies. Wright *et al.* (2005b) extensively reviewed the literature on international VC (multi-country comparisons). They indicated that the institutional dimension, namely social networks and cultures, is an under researched area and suggested using institutional perspectives along with the resource based view for a better understanding of the behaviour of VCs across countries.

2.9 Summary and Discussions

SMEs face higher constraints to access external finance than larger corporations (Beck and Demirguc-Kunt, 2006). This is a result of information opacity causing 'information asymmetry' and 'moral hazard', lack of collaterals, and weak cash flows (Berger and Udell, 1998). A 'finance gap' occurs when opportunities arise in a venture beyond the capacity of personal or internal funding (Jarvis, 2006). Before resorting to external finance, many entrepreneurs use bootstrapping techniques through reducing capital requirements, applying more efficient cash flow, and personal sources of funding (Ebben and Johnson, 2006). Seeking external finance would be through either debt or equity; the source depends on the age and the size of the firm (Berger and Udell, 1998). Smaller and younger firms are more constrained to receive bank financing (Levenson and Willard, 2000); while the lager the start-up the more is the proportion of debt and reliance on bank finance (Cassar, 2004). Many high growth firms and start-ups with limited collaterals such as high technology firms are more likely to resort to external equity financing in the form of business angels and venture capitalists (Berger and Udell, 1998). Most recently using the internet technology, crowdfunding emerged to be another supplier of entrepreneurial finance in the form of equity (Schwienbacher and Larralde, 2010). Angel investors are greater in number and volume of investments than VCs (Fairchild, 2011). They would fill the gap before seeking venture capital (Schwienbacher, 2007), yet they remain with several value adding activities over and above the finance (Mason, 2007; Kerr *et al.*, 2014). Venture capital emerged to be a significant supplier of capital for entrepreneurs by overcoming the information asymmetries (Gompers and Lerner, 2001). The VC industry is growing worldwide and the US model is sought by many developed and developing economies (Wright *et al.*, 2005b; Bruton *et al*., 2005).

In the light of the previous literature, entrepreneurship could be a solution for developing countries to create jobs and stir innovation, most importantly by promoting HGEs. The domain of entrepreneurial finance has proved to be of high importance towards promoting entrepreneurship. Equity tools in the form of angel financing and venture capital were found to be of indispensable importance for the growth of HGEs. Thus researching entrepreneurial finance and VC in Egypt is believed by this researcher to be of crucial importance; with the potential to contribute significantly to the recovery of the Egyptian economy.

The next chapter of the thesis will first contextualise the research in the light of the previous literature for the case of Egypt. It is then followed by the theoretical framework, namely institutional theory, which is further utilised in the analysis of the findings.

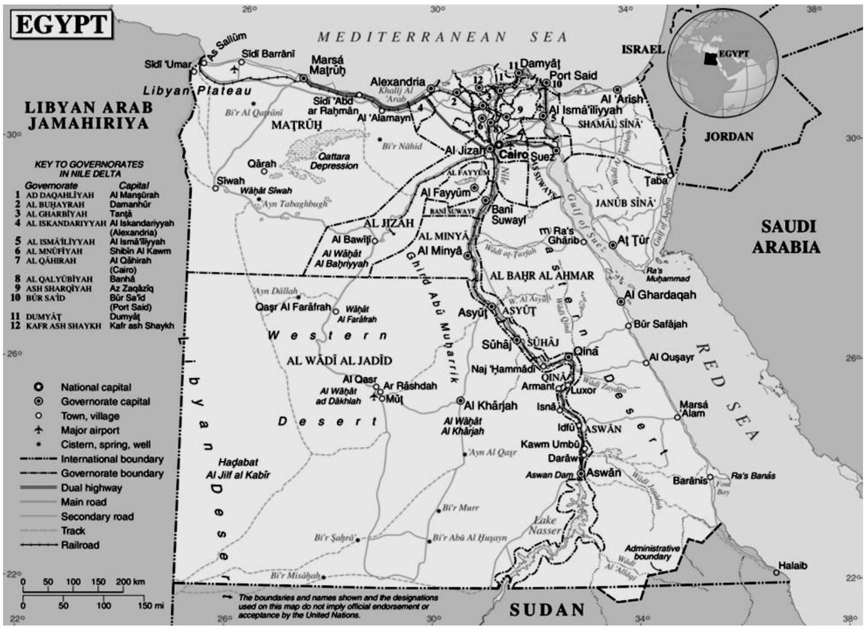
Chapter Three: Overview on Egypt and Access to Finance

3.1 Introduction

This chapter is an overview on Egypt while exploring the environment of entrepreneurship and the available sources of finance. At some parts, it is important to relate to the MENA region to fully understand the context of Egypt as an integral part of the region. The chapter will start with an overview on Egypt, the key socio-economic indicators, its business environment, and the government's reform attempts. Also it will illustrate the domain of SMEs and its importance to the Egyptian economy. It is followed by an assessment on the demand side of entrepreneurial finance represented in entrepreneurship using data from GEM report on Egypt and MENA. The situation of SMEs access to finance and entrepreneurial finance in Egypt and the key regulatory institutions will be further illustrated. A brief on the currently available debt and equity financial tools in Egypt will be discussed. Sources of funding are grouped into debt financing tools, the Social fund for Development as the official provider of capital to SMEs in Egypt, and finally equity financing. Debt finance options in the Egyptian market are SME banking, leasing, and factoring, also this part will highlight the supporting role of credit guarantee and credit rating in SME banking environment in Egypt. After, is an illustration on equity financing tools including the Nile Stock Exchange (NILEX) entitled to SMEs equity market, and BEDAYA fund for SMEs, as well as an overview on alternative sources of funding such as business angles, and venture capital in Egypt. The chapter will end with a summary on the ecosystem of entrepreneurial finance in Egypt.

3.2 Overview on Egypt

Map (3.1): Egypt, Arab Republic of

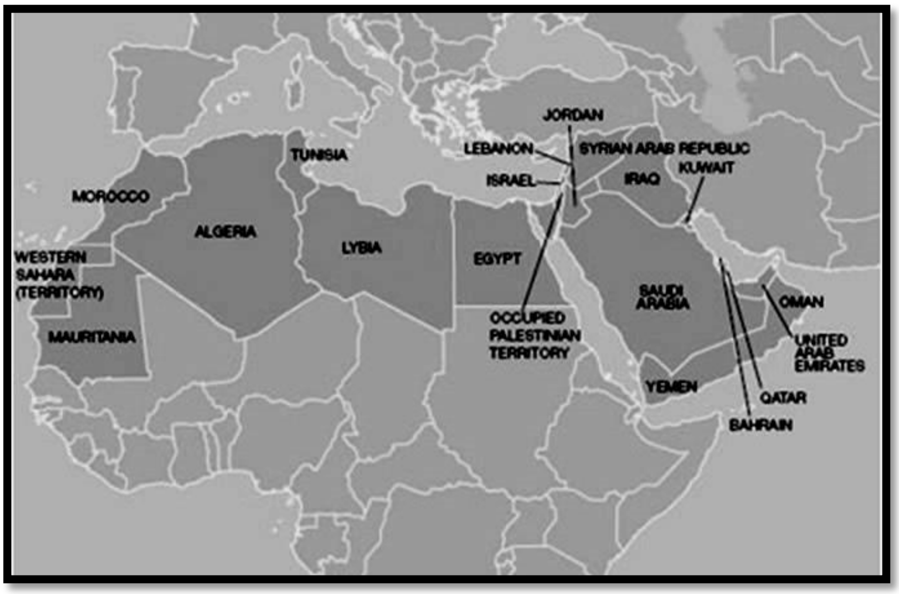


Source: www.mapsof.net

Modern Egypt as a republic was established after July 1952 when the monarchy was put to an end by the military. The king of Egypt was overthrown and the new republic of Egypt came in place. Naguib was the first official president that was later forced into a house arrest in 1954. Nasser came to power and adopted a socialist and centralised economic regime, state owned enterprises appeared and nationalisation was the main stream (Amin, 2000). During the 1970s, Sadat adopted an open-door policy which encouraged openness to the outer world and witnessed the emergence and growth of the private sector (Amin, 2000). Since 1982, when Mubarak came to power, the government of Egypt (GOE) made further adjustments towards a market economy by privatisation and more involvement of the private sector in the economy (Amin, 2004).

Egypt is an integral part of the MENA region. The region shares common culture, language, and religion as well as political and demographic similarities. However, the region is of a high economic diversity, with oil rich countries such as Kuwait, Qatar, Saudi Arabia, and United Arab Emirates and others with scarce resources and high population such as Egypt, Jordan, and Syria (World Bank, 2013). They are commonly classified as resource-rich, labour abundant countries, including Algeria, Iraq, Syria, and Yemen; resource-rich, labour-importing, including Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, The United Arab Emirates, and Libya; and resource-poor countries, including Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Tunisia, and the Palestinian Authority (O'Sullivan *et al*., 2011).

Map (3.2): MENA Region

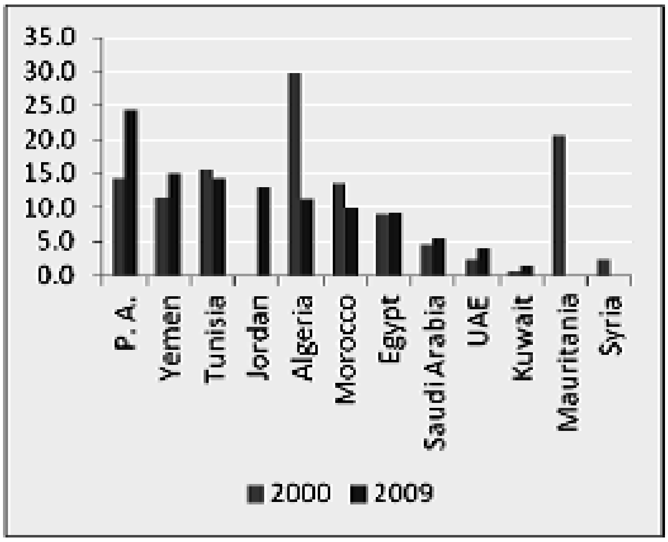


Source: www.ohchr.org

The population of the region is 355 million inhabitants, with almost 23% living on less than 2 USD a day and 4% on less than 1.25 USD a day (World Bank, 2013). Egypt alone contributes to 23% of the total region's population (World Bank, 2013).

The GDP growth of the region was 5.6% in 2012, declined by half reaching 2.8% in 2013, and was expected to increase again in 2014 (World Bank, 2013). It's notable that MENA oil exporting countries had a GDP growth of 5.7% in 2012 resulting in a current account surplus of about 440 billion USD in 2012 (IMF, 2012) which shows economic divergence across MENA countries. The GDP growth of Egypt was 6.8% in 2006, reached 7% in 2007 and 2008, then declined to 5% in 2009 and 2010, and further declined to 2% in 2011, 2012, and 2013 (World Bank, 2015). Inflation rates in the MENA increased from 6.6 % in 2010 to 9.3% in 2011 and reached 11.3% in 2012 (IMF, 2012). Egypt's high inflation rates reached 7.6% in 2006 and then over 10% in 2011(World Bank, 2013). Although, GDP in Egypt doubled from 2007 from approx. 130 billion USD to 257 billion USD in 2012 and reaching 272 billion in 2013, GNI per capita (Atlas method) increased from just 1,390 USD in 2006 and reached 2,980 in 2012, and 3,140 in 2013 with problems of poverty escalating from 19.6% of population under poverty line in 2005 to a staggering 25% in 2011(World Bank, 2013; 2015). Besides poverty and hard economic situations in the resource scarce countries, which constitutes the vast majority of the region, unemployment rates reached as high as 24% in 2009 which is the highest among all world regions (Roudi, 2011). Egypt's official unemployment rate has been 10% for the last 10 years (O'Sullivan *et al*., 2011). The problem with unemployment and the inevitability for job creation is the major challenge facing the Middle East and North Africa (Youssef, 2004); and it is expected to deteriorate with the current political and economic instability (O'Sullivan *et al*., 2011).

Figure (3.1): Unemployment Rates Percentage in 2000 and 2009



Source: O'Sullivan *et. al*., 2011:via World Bank 2011

The combination of poverty and unemployment triggered the Arab spring uprising among other reasons such as, dictatorship, corruption, and police brutality. The uprisings added to the economic burdens and the need for major economic and political reforms affecting Foreign direct investment (FDI) and tourism the most in Egypt (O'Sullivan *et al*., 2011). The large youth population of the region could be considered as an economic opportunity, yet challenges such as unemployment, underemployment, female unemployment (Gender gap), brain drain, and increasing cost of livings added weighed down the youth of the region (Roudi, 2010). The private sector in Egypt contributes to 70% of non-agricultural employment (O'Sullivan *et al*., 2011); yet there remains high unemployment even among the highly educated (O'Sullivan *et al*., 2011). Most of the education in MENA prior to the 1990s was preparing youth to state jobs and not the private sector; leading to lower productivity levels and thus slowing economic growth compared to other developing countries such as South-East Asia (Veganzones-Varoudakis, 2006). Thus, the education system might be partly responsible for this high unemployment.

Table (3.1) illustrates the contribution of youth to total labour force by gender compared to the rest of the world.

Table (3.1) Labour Force Participation (LFP) and Unemployment (U) Rates (%) Among Youth Ages 15-24, By Gender and Region, 2009

	Total		Male		Female	
	LFP	U	LFP	U	LFP	U
North Africa	**38**	**24**	**53**	**20**	**23**	**32**
Middle East	**36**	**23**	**51**	**20**	**22**	**31**
Central & South-Eastern Europe (non-EU) & CIS	42	29	48	21	35	21
Developed Economies & European Union	50	18	53	20	48	16
Latin America & the Caribbean	52	16	62	13	43	20
South-East Asia & the Pacific	52	15	59	14	44	16
WORLD	**51**	**13**	**59**	**13**	**43**	**13**
Sub-Saharan Africa	58	12	63	12	52	12
South Asia	47	10	64	10	28	11
East Asia	59	9	57	10	62	7

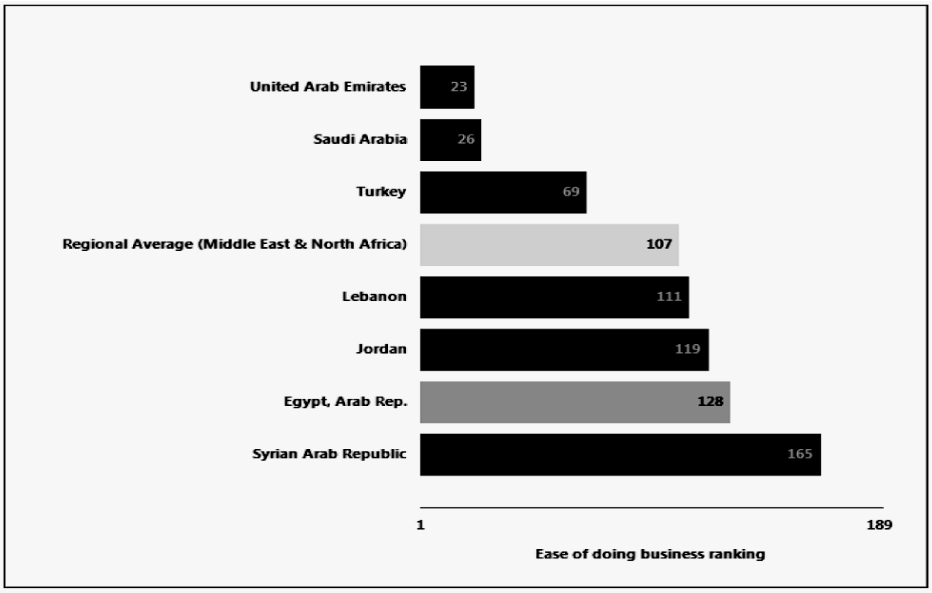
Source: (Geneva:ILO, 2010): (Roudi, 2010)

It is argued that economic integration of the MENA region would help in the prosperity of its countries; little of this integration is taking place whether on trade, labour, capital flow, or regional economic policy coordination (El-Erian and Fischer, 1996). MENA is a region of diverse economies, have the benefit of a large youth population, yet the vast majority are burdened by economic challenges, unemployment and underprivileged education. It is widely agreeable that entrepreneurship is a sound resolution to overcome unemployment; moreover, it has proven to be of significant effect on the economic development of nations (Eid, 2006).

3.3 Business Environment in Egypt

The business sector in Egypt has survived a radical change since the 1950s till present time. The shift from an era of national industries and state owned enterprises to an era of privatisation and major contribution of the private sector has taken the GOE over thirty years to approach a free market economy. Several reforms had taken place which came clear in the 'Doing Business Report' by the World Bank (2008) as being on top of all reformers 2006/07 jumping 26 places in one year and second in business start-up reformers for the same years. Compared to 178 countries, Egypt ranked 43^{rd} on procedures to open a business, 16^{th} on days to open a business, 102^{nd} for the cost to open a business. This makes Egypt easier to open a business in, yet more costly than most of the world. Further reforms took place in 2009, paid in minimum capital was reduced by 20%, and cost was reduced as a result of bar association fees' abolishment and time was cut due to tax registration automation; in 2010, Egypt had eased the business start-up process by eliminating the minimum capital requirement and in 2011 it reduced the cost to start a business. However, according to 'Doing Business Report' (2013) there were no further reforms between 2011 and 2013. According to same report for doing business in year 2014, which is published in 2013, Egypt ranked 50^{th} out of 189 countries on procedures to open a business, with an overall rank of 128^{th} for ease of doing business. Egypt ranked a 149^{th} for gaining construction permits and 105^{th} for getting electricity and property registration. Regarding access to credit Egypt ranked 86^{th} while 147^{th} and 148^{th} for protecting investors and paying taxes respectively. It was 83^{rd} for trading across borders and 156^{th} for enforcing contracts and 146^{th} for resolving insolvency. This shows a clear deficiency in the rule of law governing the Egyptian business environment. It also signals an attention on bankruptcy laws which is one of the worst in the world according to the report. Although Egypt ranks well below average on the overall ease of doing business compared to MENA region, it came 3rd after the UAE, and Morocco on ease of starting a business and a joint second with UAE and Oman for ease of getting credit while Saudi Arabia came 1st. Egypt performed poorly and was ranked 16th of 20 countries in the region for protecting investors and resolving insolvencies. The weakest performance was in enforcing contracts were it was ranked 18th and second from last ranked 19th for paying taxes in the region.

Figure (3.2): How Egypt and Comparator Economies Rank on the Ease of Doing Business

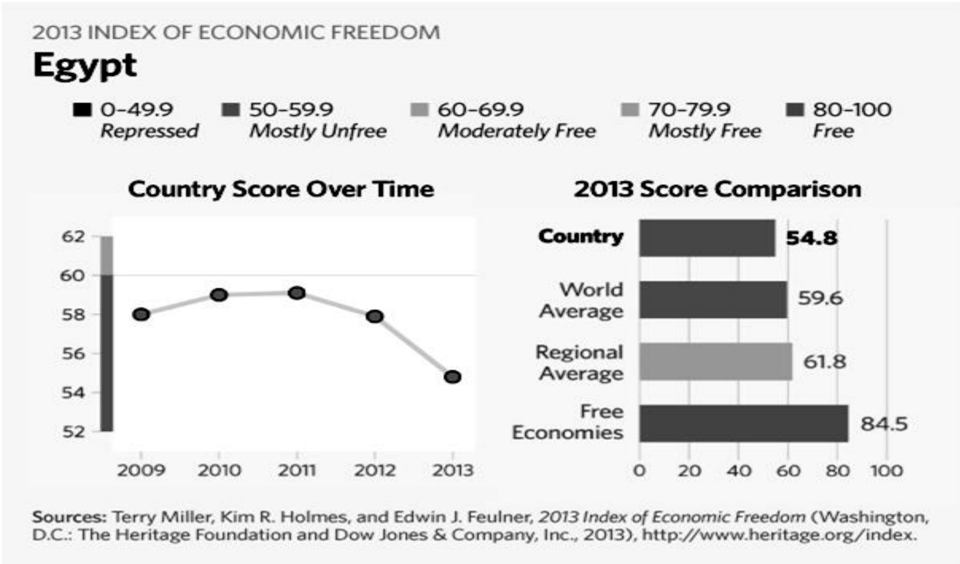


Source: IBRD, (2013)

According to the Worldwide Governance Indicator (WGI), Egypt scored an overall 26.5% on the scale of 100%. The WGI report (a research dataset part of the World Bank Group) six aggregate governance indicators for 215 countries and territories over the period 1996-2012, covering i) Voice and Accountability, ii) Political Stability and Absence of Violence, iii) Government Effectiveness, iv) Regulatory Quality, v) Rule of Law, and vi) Control of Corruption (WGI, 2014).

On the Index of Economic Freedom (EFI), Egypt also performed poorly with an overall declining trend in the past five years and an overall 'mostly un-free' economy.

Figure (3.3): 2013 Index of Economic Freedom, Egypt



3.4 SMEs in Egypt

Regarding the SMEs sector, in June 1998 "A Draft National Policy on Small and Medium Enterprise Development in Egypt" took place as a result of economic pressures burdening the GOE at that time. The Underserved segment of SMEs was found to be of high priority for the development of the socio-economic dimension in Egypt, according to the draft national policy (1998). The report identified five main "constraints", financial, input, marketing, regulatory, and management as institutional constraints. It then assigned a conceptual framework and general policy guidelines as a requirement of developing the sector. In another complementing report "Enhancing Competitiveness for SMEs in Egypt" (2004a), guidelines and policy frameworks were set to enhance the competitiveness of SMEs in Egypt in the globalising world economy such as: promotion of direct exports, business development services, financial services, and innovation enhancing measures, organic clusters, networking and creating a favourable legal and regulatory environment.

According to the OECD (2010a) report on SME policy and promotion in Egypt, 'medium-sized, small and micro-enterprises account for over 90% of active businesses and contribute to over 80% of GDP and 75% of total employment. The Global Entrepreneurship Monitor's (Hattab, 2008) report for Egypt in 2008 estimated over 13% of adults were in the process of starting a business or already owned one that was under three years old. With an average of 1.83 jobs per start-up, the report estimated that the job creation potential of the 1.34 million ventures created in 2008 was significant: if they succeeded, they would create some 2.5 million potential jobs.

3.5 Entrepreneurship in Egypt

Entrepreneurship and entrepreneurial activities represent the demand side of entrepreneurial finance and VC. Thus, it is important to understand the implications of entrepreneurship in Egypt as one of the determinants shaping its entrepreneurial finance sector. It is hard to set a clear differentiation between the business owner i.e. SMEs, and entrepreneurship in Egypt. This was evident in the policy approaches targeting the sector which are mostly directed for the SMEs in general. Also regarding the GEM report on Egypt (Hattab, 2008; 2011) the sample does not differentiate between the two, however the GEM classification on necessity-motivated entrepreneurs and opportunity-motivated entrepreneurs partially helps in this differentiation. Global Entrepreneurship Monitor (GEM), a renowned research based initiative focuses on entrepreneurship and entrepreneurial activities across the world. The GEM included Jordan since 2004 in their global report, the United Arab Emirates (UAE) since 2006, and Egypt since 2008. In 2009, a regional report on MENA included 7 countries from the region as its base. The GEM-MENA report 2009 (Stevenson *et al.*, 2010) as well as the work by Eid (2005; 2006) showed heterogeneity among countries in the MENA region signaling a motive for country specific research and that generalisation within the region should be dealt with care. However, it remains indicative on the general direction of entrepreneurship and main themes arising across the region. Specifically, the cultural dimension which is relatively homogenous across the region was of significance to this study.

3.5.1 Perception of Entrepreneurship

On GEM global report 2012, over 75% of the respondents in MENA region considered entrepreneurship to be a good career choice, the same case was with Latin America and Sub-Saharan Africa (Xavier *et al.*, 2013). In addition, the status of entrepreneurship in MENA is considered high and societies view positively a successful entrepreneur and have a low fear of failure to start their business (Stevenson *et al.*, 2010). Regarding the perception and status of entrepreneurs in Egypt, Egypt ranked 12th among the 43 GEM countries with adult population considering entrepreneurship as a career and perceived status of successful entrepreneurs highly in 2008, which even improved in percentage in 2010 to become the 14th among 59 countries ahead of many efficiency and innovative driven countries (Hattab, 2008; 2011) . With 90% of the Egyptian population believes that a successful entrepreneur gets a high status in the society and 70% think the media gives adequate coverage on entrepreneurs (*op cit.*). In 2008, Egypt signalled a very low fear of failure rate ranking second after Iran indicating a surprising appetite for risk; however this has changed in 2010 to rank Egypt 11th among the 59 GEM countries (Hattab, 2011). This is still a positive aspect in the country which indicates a good mindset for entrepreneurship and low fear of failure. Moreover, it was found that 63% of the Egyptian population believes they have enough knowledge and qualifications to start their own business, however, on the other hand only 25% would consider a starting their own business in three years time (*op cit*.).

3.5.2 Entrepreneurship Activity

A total of 2.7 million are entrepreneurially active in Egypt in 2010; starting 731,000 new enterprises compared to three million nascent entrepreneurs in the process to start 1.34 million new enterprises in 2008 (Hattab, 2008; 2011). Egypt was ranked last on the TEA for factor-driven economies in 2010 (Hattab, 2011). Egypt was ranked 11th among 43 countries in the early stage Total Entrepreneurial Activity (TEA) (Hattab, 2008); however it deteriorated in the ranking in 2010 to become the 37th among 59 countries (Hattab, 2011). Nevertheless, the region is considered to have low rates of entrepreneurship activity and establishing businesses compared to the rest of the world (Xavier *et al.*, 2013). Although, 24% of the adult population in MENA is involved in an entrepreneurial activity (Stevenson *et al.*, 2010), only 0.6 new limited liability firms per 100 adults entered the economy in the MENA region during 2004-2009 (OECD, 2013). When compared to over 4.2 in high-income countries, 2.2 in Europe and Central Asia and 1.3 in Latin America it shows the low level of business formation in the region, furthermore even if the formal and informal sectors are combined it still lags behind other emerging economies (OECD, 2013). This could indicate a large sector of informal businesses in addition to the large number with an 'intention' to be an entrepreneur, which is included in GEM's data of entrepreneurial activity. It could be an opportunity for policy makers to build on the momentum of those intending to start their business to become entrepreneurs and establish their own businesses.

3.5.3 Motives for Entrepreneurship

There are different motives towards entrepreneurship; the GEM research categorises entrepreneurs to necessity driven, where entrepreneurs are forced to start their business out of poverty conditions, and opportunity driven where entrepreneurs find a good business opportunity and pursue their trade accordingly. In the case of MENA, it was found that 27% of entrepreneurial activity is necessity driven; it also showed that it ranges from 8% in UAE to over a third in Yemen (Stevenson *et al.*, 2010). Albeit, the UAE has the lowest necessity entrepreneurs, two thirds of Emiratis would start a new venture primarily to increase their income (El-Sokary, 2013). In the case of Egypt in 2008, “opportunity-entrepreneurship” and “necessity-entrepreneurship” had a ratio of 4.3:1 which was a positive sign and “unexpected” for types of entrepreneurs in developing countries (Hattab, 2009: p.14). However, this has changed dramatically, in 2010 it was found that 53% of early stage entrepreneurs were necessity driven which was one of the highest for GEM countries (Hattab, 2011). It is confirmed within GEM studies that necessity entrepreneurs are much higher in low income countries than high income; however, the MENA region with only 27% necessity entrepreneurs is much lower than other low-income parts of the world that reaches up to 45% (Stevenson *et. al.*, 2010). Usually in Latin America and Asia women contribute to a large portion of necessity entrepreneurs which might explain how MENA is low on this aspect as it has a very low participation of female entrepreneurs (Xavier *et al.*, 2013). Another explanation might be the charitable

Islamic practices in the region which leads to less necessity and thus less necessity driven entrepreneurs (Stevenson *et al.*, 2010).

3.5.4 Demography of Entrepreneurs

Regarding the demographics of Entrepreneurs in MENA, a gender gap is highly apparent and is one of the highest in the world (Stevenson *et al.,* 2010); notable in Egypt and Palestine where less than 20% of entrepreneurs are women (Xavier *et al.*, 2013). In MENA, men are 2.8 times more likely than women to start their business (Xavier *et al*., 2013); with countries such as Syria and Palestine reaching 4 to 1 while Yemen and Algeria would reach 1.5 to 1 all in favour of men (Stevenson *et al.*, 2010). Regarding age of entrepreneurs, the findings were consistent with the rest of GEM countries where the majority of entrepreneurs were within the age bracket of 25-34 years. Given that there are 90 million individuals in MENA in the age of 15-24 in 2010 (Roudi, 2010), this provides the region with a large group of potential future entrepreneurs. The intentions to start a business increases with the level of education and household income in MENA which is in line with the rest of the world, yet less than 5% of adults received any training or formal education on how to start a business (Stevenson *et al.,* 2010).

3.6 SMEs Access to Finance in Egypt

Access to finance has long been an issue for the Egyptian business sector; it has been underdeveloped till the early 2000s when compared with other GCC MENA region (OECD, 2010). However, access to finance remains highly unfavourable for MSMEs all over the MENA region; it is estimated that the financing gap for MSMEs in MENA is 320 to 390 billion USD (IFC, 2011). In Egypt, 49% of nascent entrepreneurs will totally self finance their ventures while 51% will seek external funding (Hattab, 2011). The start-up capital required to start a business is of a median of 50,000 EGP (approx. 4,500 GBP); 91% of businesses can be started with 500,000 EGP (approx. 45,000 GBP) or less (Hattab, 2008).

According to OECD (2010b) report on access to finance in Egypt, the GoE had undergone major reforms staring from 2004. This financial sector reform included the the banking sector, introducing a centralised non-banking financial services regulatory authority (Egyptian Financial Regulatory Authority, EFSA)**,** improving the stock market exchange, attempting to enhance risk capital, developing credit guarantee schemes, and improving credit rating and quality of information. However, further improvement is needed to enhance the financial sector, such as updating bankruptcy laws, promoting risk capital, and improving financial literacy, among other suggestions (OECD, 2010a).

3.7 Financial Regulatory Institutions

There are two main institutions that regulate the financial markets, the Central Bank of Egypt (CBE) for all the banking activities, and the Egyptian Financial Supervisory Authority (EFSA) governing all the non-banking financial services. The Central Bank of Egypt (CBE) is an autonomous regulatory body, assuming the authorities and powers vested therein by Law No. 88 for 2003, and the Presidential Decree No. 65 for 2004 (CBE, 2013). The main objectives of the CBE as published on their website are realizing price stability and ensuring the soundness of the banking system; formulating and implementing the monetary, credit and banking policies; issuing banknotes and determining their denominations and specifications; supervising the banking sector; managing the foreign currency international reserves of the country; regulating the functioning of the foreign exchange market; supervising the national payments' system; and recording and following up on Egypt's external debt (public and private) (*op.cit*.). The CBE as part of a national programme issued a decree on improving SMEs finance in Egypt. The CBE and the Egyptian Banking Institute (EBI), which is a non-profit organisation since 1991 under the auspices of the CBE responsible for qualification, training and research for the Egyptian banking sector (ebi.org.eg), established a dedicated SME unit in 2009 for the specific purpose of enhancing SMEs financing environment (SME-Egypt, 2013). The unit is part of the Business Development Support Services Project (BDSSP) funded by the Canadian International Development Agency (CIDA). The definition of SMEs is a highly debatable issue (Gibson and van der Vaart, 2008) and details on definition are beyond the scope of this research. However, the definition of SME in Egypt is according to the law no. 141 for the year 2004 on Development of Small Enterprises; a small enterprise should have a paid in capital of not less than 50000 EGP (approx. 4,500 GBP) and not more than 1 million EGP (approx. 90,000 GBP), and with no more than 50 employees, a Very Small Enterprise (VSE) should have a paid in capital of less than 50000 EGP (approx. 4,500 GBP) (SFD, 2013). According to EBI publication, the turnover of a small enterprise is between 1 and 10 million EGP (approx. 90,000 to 900,000 GBP) per annum, while a medium enterprise annual sales are between 10 and 100 million EGP and an employment of between 50 and 200 employees (Poldermans, 2011). In December 2008, the CBE passed a regulation by reducing the reserve requirements for SME lending in an effort to provide a financial incentive to the banks (Poldermans, 2011).

The other regulatory institution in the financial market is the Egyptian Financial Supervisory Authority (EFSA). The EFSA is responsible for governing all the non-banking financial activities, including 'the Capital Market, the Exchange, all activities related to Insurance Services, Mortgage Finance, Financial Leasing, Factoring and Securitization' (EFSA, 2013). EFSA is established in accordance to law 10 of the year 2009. The Egyptian Financial Supervisory Authority is a replacement for the Egyptian Insurance Supervisory Authority, the Capital Market Authority, and the Mortgage Finance Authority in application of the provisions of the supervision and regulation of Insurance law no. 10 of 1981, the Capital Market law no. 95 of 1992, the Depository and Central registry law no. 93 of 2000, the Mortgage Finance law no. 148 of 2001, as well as other related laws and decrees that are part of the mandates of the above authorities; and EFSA is the concerned administrative body entitled to apply the Financial Leasing provisions promulgated by law no. 95 of 1995 (*op. cit*.). This was all part of the financial services reform that took place in 2004 including all banking and non-banking financial services. EFSA is also the supervisory body for micro finance and venture capital under the law no. 95 of year 1995. One of EFSA's main objectives is "Support efforts aiming at developing non-banking financial markets to enhance methods and possibility of market penetration" which includes facilitating financing access by SMEs (EFSA, 2013).

3.8 Overview on SME Financial Tools in Egypt

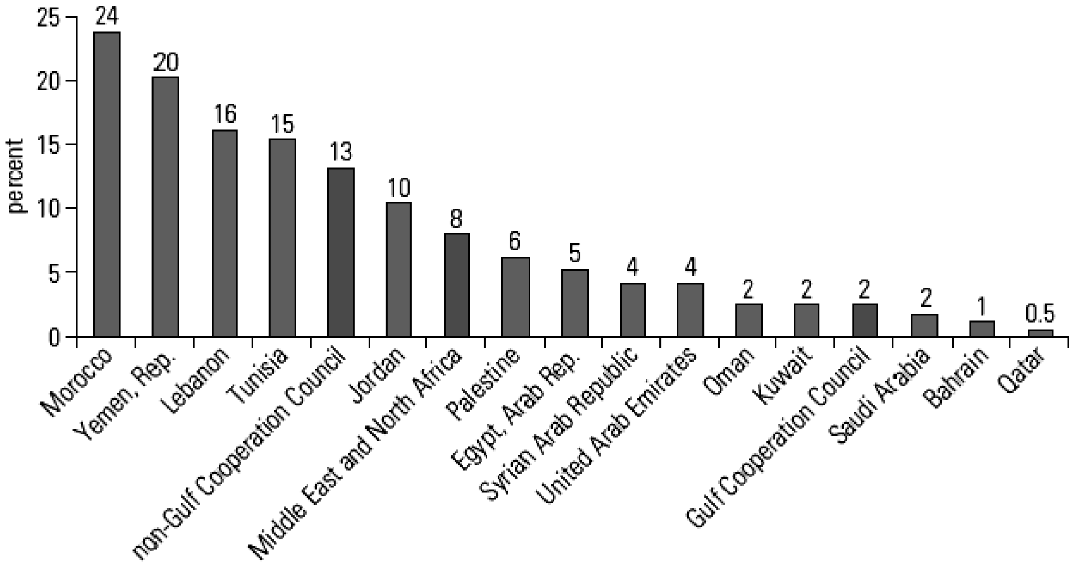
3.8.1 Debt Financing

3.8.1.1 SME Banking

Bank credit is the dominant and mostly the only significant source of finance to the private sector in the MENA region (Rocha *et al*., 2011). On the other hand, SMEs access to bank finance is limited all over the MENA region with a very small percentage of the total lending portfolio of an average of 8% compared to 16.2% for middle income countries and 22.1% for high income countries; Egypt is no exception counting to 5% of the total lending in 2009 (Rocha *et al*., 2011). SME banking in Egypt started to pick up in years 2004 and 2005 as a national strategy direction; around half of the 39 banks in Egypt are currently involved in SME banking (Poldermans, 2011).

Based on an SME nation-wide census, the Central Bank of Egypt (CBE) and the Egyptian Banking Institute (EBI) commissioned the Central Agency for Public Mobilization and Statistics (CAPMAS) conducted a survey on the economy of SMEs in Egypt. El-Said, Al-Said, and Zaki (2013) analysed this data and came with a conclusion that less than 50% of the sample deals with banks and very few are able to export. They also found that the concentration is highly skewed toward only three governorates with almost 50% in Cairo, Sharqia, and Gharbiya mainly in the manufacturing and trading sectors. Almost 60% of the legal setup of the SMEs sample was a sole proprietorship and the remaining 40% distributed among other forms of companies with only 7.3% as stock joint. Noticeably, 82% of the SMEs were of a capital of less than 250,000 EGP (approx. 23,000 GBP), and almost 85% with less than 20 workers and over 50% have a turnover of less than 500,000 EGP (approx. 45,000 GBP). Worth to mention is that within the 47% who deal with banks, only 22.4% have facilities from the banks. It is clear that SMEs in Egypt especially those with less than 20 workers and capital less than 250,000 EGP have a serious obstacle to access banking finance (El-Said *et al.*, 2013).

Figure (3.4): SME Loans as a Percentage of Total Loans in Selected Economies in MENA, 2009



Source: Roche *et al.*, (2011)

Adding to the problem of banking finance to SMEs, the banking sector in general is shy on lending to the private sector. Herrera, Hurlin, and Zaki (2013), pointed that there is a 10 per cent fall in private credit in the banks in Egypt after January 2011. They mentioned that credit to the government accounted to the majority of this decline while reduced economic activity contributed around 15 per cent of the total fall in credit. Moreover according to a survey by NILEX (Nile Stock Exchange for Mid and Small Cap), only 6% of the Egyptian banks total portfolio is directed to SMEs with a 92% rejection for the total applications (OECD, 2010b). This signals that banks are adding to the pressure of access to finance of the private sector, nonetheless it adds more impediments in front of SMEs accessing bank finance.

3.8.1.2 Leasing

There are currently 207 registered leasing companies (EFSA, 2013). According to the Egyptian Leasing Association (ELA), “most of these companies are inactive, as they are essentially "single-contract companies", established for the purpose of one-off leasing deals enabling them to benefit from the five-year tax holiday granted to financial leasing companies” (ELA, 2013). Accordingly, the financial leasing industry in Egypt consists of 10 major market players, accounting for more than 90% of the new contracts in the market. Leasing in Egypt is governed by Law 95 for 1995, and it is for commercial purposes only and excludes targeting consumers (*op. cit.*).

Within the scope of the SME policy development project (SMEPoL), Ministry of Finance (MoF, 2004b) published a report on enhancing opportunities for SME leasing. The report addressed the regulatory and technical problems facing SME leasing, however, it emphasised the importance of leasing as a financial tool that can considerably facilitates SMEs access to finance in Egypt (*op. cit.*). Egypt is one of few MENA countries that strive to grow its underdeveloped financial leasing sector, knowingly that it can play a significant role especially to SMEs, however many impediments including financial and regulatory factors is hampering its development (Nasr, 2004). It is argued that leasing is an important financial tool for SMEs when supported by credit guarantee schemes (Kraemer-Eis and Lang, 2012). *“The small size of the leasing industry in MENA is disappointing. The industry is Sharia compliant by its nature and could provide an important alternative source of investment finance for small, medium, and even large enterprises, especially in a region where the collateral regime remains weak, depriving many enterprises of credit”* (Rocha *et. al.*, 2011; p.83).

3.8.1.3 Factoring

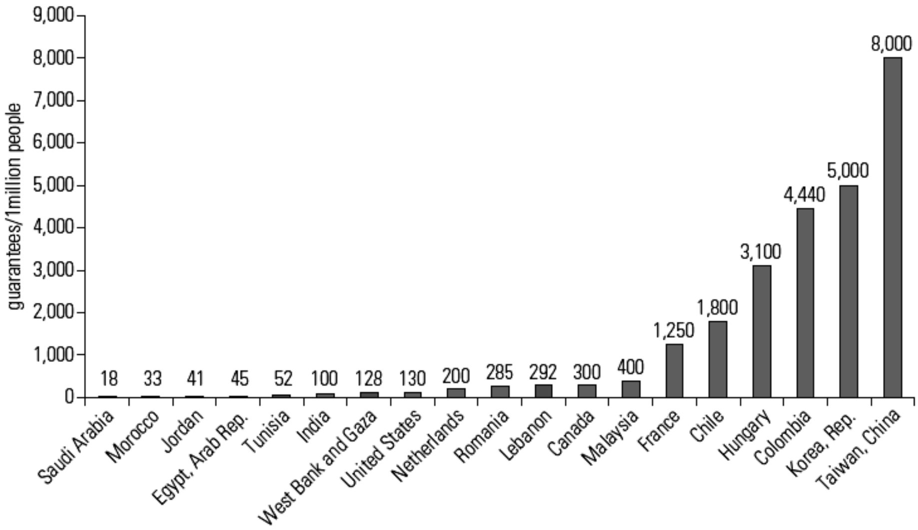
Factoring is another debt financing tool, where factoring companies discount collectable invoices incurring a fee or percentage in exchange of immediate cash. It is a growing source of financing all over the world for large corporations and SMEs (Klapper, 2006). In the case of Egypt there are only two licensed Factoring companies of which only one is operational (MoI, 2013). 'Egypt Factors' was established in 2006 in a joint venture between Commercial International Bank Egypt (CIB) 40%, FIMBank Malta 40%, and International Finance Corporation (IFC) 20% (egyptfactors.com). According to the company's website, the business has to generate 40 million EGP (3.7 million GBP) of annual sales or a monthly turnover of 3.3 million EGP (300,000 GBP) in the form of commercial receivables, to be able use factoring services. The company funds between 80 to 90% of the purchased invoice in cash, and they cover international and domestic trading (*op cit*.).

3.8.1.4 Credit Guarantee

An important component in facilitating SMEs access to finance is a credit guarantee institution (OECD, 2010b). It is aspired that this form of initiative would encourage banks towards more SME lending. In Egypt, an initiative between the Ministry of International Cooperation, the United States Agency for International Development (USAID), and the Credit Guarantee Company lead to the establishment of an SME credit guarantee programme (CGC, 2013). Credit Guarantee company was established in 1991, yet the SME programme was launched in 2011. The main objective of the programme is to enhance the role of banks in SME credit to help in the economic growth of Egypt by decreasing unemployment and increasing exports of SMEs. The target business is an investment cost of 40,000 EGP till 50 million EGP.

They have no sector preference and finance fixed assets as well as working capital. The minimum required credit should be no less than 10,000 EGP and no more than 2.5 million EGP for a single venture. The portion guaranteed is typically 75% which increases to 80% for agricultural programmes and financial services in rural areas. The term of guarantee is of a minimum of 6months and a maximum of 5 years that could be extended upon request of the bank. The company also cooperates under a signed protocol with the Egyptian factoring company and the Egyptian company for export guarantee (*op cit.*).

Figure (3.5): Number of Guarantees per Year in Selected Economies in MENA, 2009



Source: Saadani *et al*, (2011); Rocha *et al*, (2011)

Although the CGC had achieved a 'critical size' needed to have an impact on SME lending in Egypt (OECD, 2010b); figure (3.5) shows that Egypt and the whole MENA region still have plenty of room to increase the credit guarantee activities.

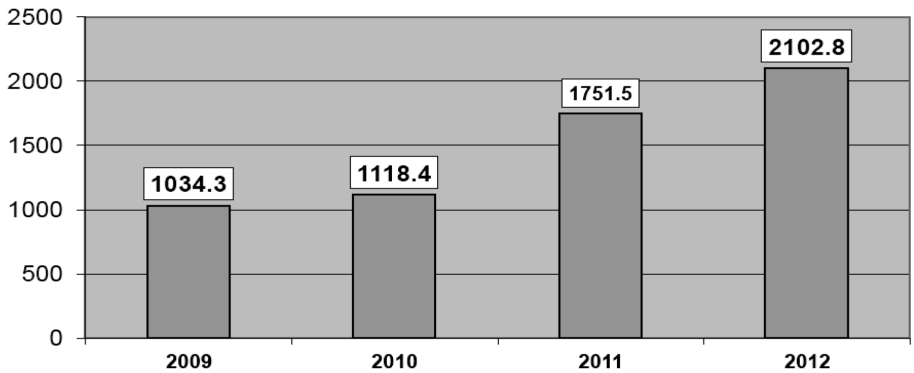
3.8.1.5 Credit Rating

Credit rating is a necessity for any economy to enhance and facilitate its access to finance, especially SMEs (OECD, 2010b). Egypt launched its first credit bureau in 2005, which till 2007 then it was fully functional. The Egyptian Credit Bureau, branded as 'I-Score', is a private company funded by 25 banks and the Social Fund for Development (I-Score, 2013). The company was established under the auspices of the CBE and with support of the International Finance Corporation (IFC) and technological support of Dun and Bradstreet (OECD, 2010b). I-Score holds database for individuals and SMEs; it now holds more than 92% of credit data of individuals and SMEs from commercial banks in Egypt (both banks and non-banks) as of June 2010 (I-Score, 2013). The activities of I-score have been very successful in improving the quality of information and ensuring greater credit transparency (OECD, 2010b).

3.8.2 Social Fund for Development (SFD)

The SFD focuses on poverty alleviation and regional inequality in the more deprived areas such as the Upper-Egypt, it is the largest governmental institution representing and responsible for small enterprises in Egypt (OECD, 2010a). A law on micro and small enterprises MSEs was introduced in 2004 that targeted to improve and promote small enterprises in Egypt through the SFD. According to the SFD official website the role of the SFD ranges from financial services, non-financial service, and community development. The financial services constitutes of direct lending, finance through intermediary agencies and banks, finance through franchising, and micro-finance. As for the non-financial services, they offer training and training courses, internal and external exhibitions, business and technology incubators, and other services such as marketing, technical support, business development, and feasibility studies. Regarding the community development, SFD finances infrastructure projects, community development projects, and environment related projects. The SFD remains the top recipient of donor agencies and developmental agencies in Egypt. In 2012, SFD signed 6 agreements with the World Bank, European Investment Bank, United Nations Development Programme (UNDP), Danish International Development Agency (DANIDA), International Fund for Agricultural Development (IFAD) and Arab Fund for Social and Economic Development with loans totalling 190 million USD for small and micro enterprises and grants totalling 228 million USD for labour-intensive projects and non-financial services (SFD, 2012). In Figure (3.6) shows the amount of financing disbursed during the last four years. It shows the uptrend in the outflow of capital that would also signal the strength of endowments committed to the SFD.

Figure (3.6): Amounts disbursed to MSEs within 2009-2012 in million EGP



Source: SFD Progress Report 2012

The SFD is the main co-ordinator for the MSE framework in Egypt; however it does not cover medium size enterprises and high growth enterprises (OECD, 2010a). The SFD is also broad in its activities; it has its own business incubation programme. The programme included 7 incubators both physical and virtual in Cairo and other selected governorates; SFD supplies free working space as well as business loans with a 6% interest (STFD, 2012).

3.8.3 Equity Financing

3.8.3.1 Nile Stock Exchange

Another government initiative was introduced in 2008 to enhance the access to finance to SMEs in Egypt is the NILEX, and it began trading on June 2010. It is the Egyptian stock exchange for growing small and medium enterprises. According to the NILEX brochure posted on their website, they are the first small and mid-cap market in the MENA region. They target listing any company from any sector that meets the listing requirements. One of the requirements is to have a nominated adviser. The minimum free float should be 10% of the shares and number of shareholders should not be less than 25. The issued capital should not be more than 50 million EGP when listed and should not exceed 100 million at any time. The annual listing fees are 0.5 per thousand EGP annually with a minimum of 500 EGP and a maximum of 30,000 EGP. Trading fees are 1/10 per thousand of total transaction with a maximum of 100 EGP. There are currently 23 listed companies of which 22 are trading. Two were listed in 2008, three in 2009, a record high nine in 2010, three in 2011, three in 2012, and four in 2013 of which one is not traded yet. The current numbers and volume are not what was expected from the launch of the NILEX, however the obvious effect of the political situation visible in 2011 through 2013 maybe a good explanation specially with the record high of 2010. On another level, only two companies out of the 24 listed companies are in the technology business.

3.8.3.2 Bedaya Fund

The last governmental initiative on the SME financing list is the BEDAYA fund which is established by the General Authority of Free zones and Investment (GAFI), a division of the Ministry of Investment (MoI). BEDAYA 1 is a fund specialised in PE/VC financing to SMEs in Egypt, its target size is 134 million EGP and has a fixed term of 10 years. The investment strategy is in companies of net worth between 2 and 50 million EGP and an annual turnover of not more than 120 million EGP. No more than 50% shall be invested in SMEs ranging from 25 million EGP and 50 million EGP net worth. Not less than 2% and no more than 15% are allocated to "green fields". As for the geographical allocation, not more than 40% is to be invested in SMEs in Cairo and a maximum of 25% is to be invested in one sector. The fund focuses on SMEs with high return on job creation. The Bedaya Fund is part of the GAFI initiative to support SMEs and entrepreneurship, among other services delivered in this programme is their business development services. It is an SME clinic where a full range of consultancy is delivered to assist in the growth of the SMEs. The entrepreneurship programme is where GAFI plays a catalytic role with other programmes and initiatives. Also there is a pilot project on SMEs business linkages.

3.8.3.3 Alternative Sources of Financing

This part focuses on the other equity financing tools, specifically angel financing and venture capital. The domain of alternative financing is not well established in Egypt. Until the early 2000s such forms of financing were non-existent. Although 'business angel' investment was found significant in Egypt's GEM report (Hattab, 2009), there was no evidence for organised networks of habitual business angels as known in developed economies in her research. The amount of 'angel' financing was found approximately L.E. 8.13 billion which represents 1% of the GDP in 2008; with a significant one third expecting no return at all indicating “love money” investment is in family members’ businesses (Hattab, 2008).

Regarding VC/PE activities, law no. 95 on venture capital (risk capital) and other non-banking financial tools was introduced in 1995; nevertheless, most of the registered companies under that law don’t undertake any venture capital activities and are solely seeking some tax benefits (OECD, 2010b).

The venture capital industry in Egypt is still nascent. It is relatively small with around 15 operating VC/PE firms, while most activities are late-stage funding PE firms. Entrepreneurial finance, in the form of PE/VC, is argued to promote entrepreneurship and offers solutions to create jobs and help in economic growth as proven by other economies (Eid, 2006). Promoting a venture capital industry in Egypt funding early-stage and start-ups is sought after by the Egyptian government to enhance entrepreneurship. The January revolution in 2011 emphasised the urgency to create jobs and capitalise on the young population in Egypt. Thus, further attention towards entrepreneurial finance in general and VC in particular is needed to capitalise on the unprecedented entrepreneurial momentum taking place after the revolution to enhance economic growth.

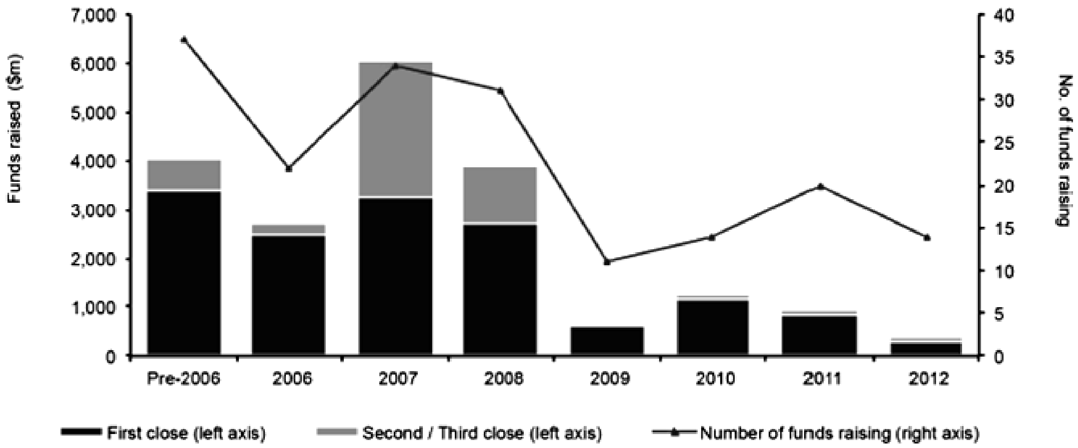
3.9 Overview on VC in Egypt and MENA

According to Eid (2006), promoting entrepreneurship and entrepreneurial finance using the capital growth in the PE market will eventually lead to job creation and economic growth in the MENA region (2006). Eid (2011) had republished her work after the Arab spring uprisings to stress on the urgency and topicality of her work to the current circumstances. *"It is not hard to understand why policymakers are such strong proponents of PE in general and VC in particular. Both academic and practitioner-oriented research has clearly demonstrated that such investing creates significant economic value"* (Megginson, 2004; 90). According to the MENA investment policy brief by the OECD (2006) investment programme focusing on its VC/PE industries, knowledge based economies are a must for a country's competitiveness and growth, and the MENA region is no exception. They added that innovation and risk taking are its major components which urge the region's policy makers to realise the need for supporting innovation and its key barriers through addressing the entrepreneurial financing gap. The report showed great optimism in VC industry's potential in the region; however, the industry was described 'nascent'. They identified three main challenges and three opportunities related to the VC/PE development in the region. The first challenge was decreasing unemployment which have been proven in other nations that VC helped in increasing employment rates, second was economic diversification in non-oil industries especially high technology ventures which is a complement of the VC industry, and third was addressing the entrepreneurial finance gap as a main hurdle towards entrepreneurship in the region. The three opportunities were, first the unprecedented liquidity caused by record oil prices accompanied by the private wealth of high net worth individuals in the Gulf reaching 1.5 trillion USD in 2007, second was the fact that VC firms worldwide are expanding and searching for new opportunities in emerging economies, and third was the compliance of the VC concept with Islamic finance which is gaining a great momentum in the region. From this policy brief further investigation for the challenges and opportunities for a VC industry was required.

According to Morales, Schlichting, and Youssef (2011), the PE industry is growing remarkably, and there needs to be a further understanding of the industry to assess its potential development; they highlighted the issues on the opacity of information and the lack of data in the region and how it’s negatively affecting understanding and thus the evaluation of the industry.

Until 2004 the private equity funds were merely over a billion USD and between 1994 and 2005 USD 5.8 billion were raised as PE with 41% raised in 2005 alone (OECD, 2006), with Egypt and UAE receiving almost 30% of the MENA PE funding since 1998 till 2006 (Zawya.com, 2006) . The MENA region and specifically the GCC has always been a target area for raising funds for PEs in the US and Europe; hence the large numbers of high net worth individuals (HNWIs) and Sovereign Wealth Funds (SWFs) (Morales *et al*., 2011). However in the last few years it managed to attract western PEs as a destination (BVCA, 2013). Before year 2000 PE only existed in Egypt for its more developed business infrastructure and privatisation opportunities; the industry started to grow in the GCC in 2004 and 2005 accompanied by the accumulated wealth of historic oil price rises (BVCA, 2013). As of 2011 there were 120 firms in the MENA region in both PE and VC activities (Morales *et al*., 2011). Figure (3.7) shows the annual raised PE/VC funds in terms of numbers and amount.

Figure (3.7): Funds raised by year



Source: MEPEA, (2013): Zawya Private Equity Monitor

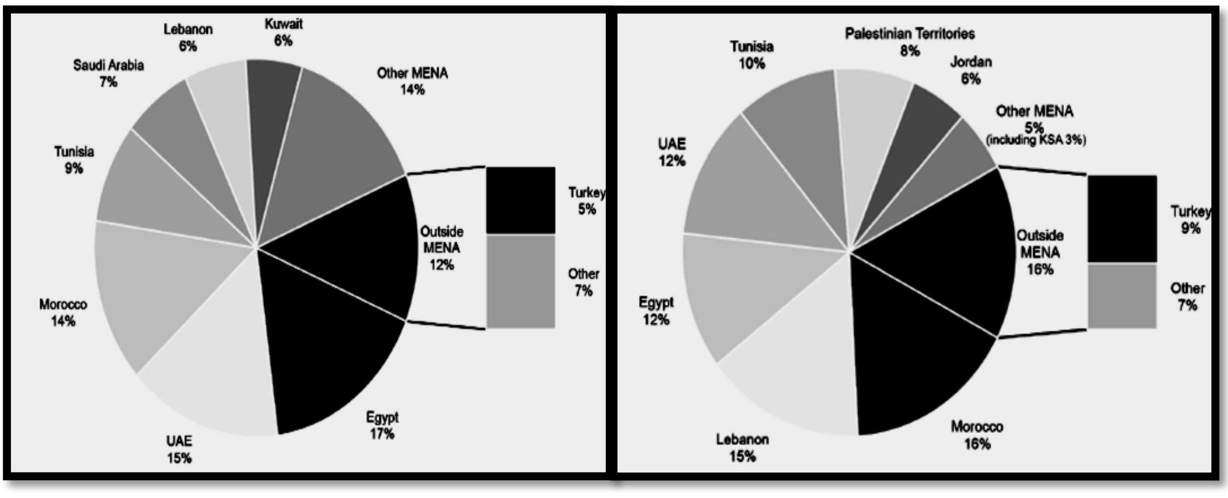
Following to the year 2006 the trend was still upwards in the fundraising and reached its peak in the year 2007; in 2008 there was a significant decline that was followed by a sharp drop in 2009 and the following years. The drop was in both the amount raised and the number of funds raising capital. This is in part an effect of the slowdown of the global economy and the financial crisis that have affected many of the regional funds as well as HNWI who suffered large losses. According to Middle-East Private Equity Association (MEPEA) report (2013), this might as well be a reflection for the increasing investors' focus on growth capital, VC and SMEs for those activities would require less sums of investment. The focus on VC and growth capital was noticed as early as 2006, *"Appetite is forming to invest in these higher-risk funds that provide seed or early-stage capital to nascent businesses"* (MEED, 2006). It prevailed more evidently post global financial crisis and the beginning of the Arab spring uprisings; *"We have seen an increase in growth capital, VC, and SME investments which are generally lower value, minority interest investments. There has been an absence of large buy out deals post the global financial crisis and is anticipated to remain the case for the next 12 to 18 months."* (MEPEA, 2013: p.11).

The current ‘democratisation’ of the region is expected to improve the entrepreneurial environment and eventually the SME sector is thought to gain a larger share of the region’s PE investments which was neglected by the PE sector (*op cit.*).

Regarding the regional share of PE investments in the MENA region, there has been a shift from Saudi Arabia and Egypt towards the Levant countries, especially Lebanon which more than doubled its share from 6% in 2006 to 15% in 2012. Also Jordan and the Palestinian Territories witnessed a significant increase reaching 6% and 8% of the total investments respectively. Morocco witnessed a slight increase from 14% to 16% to become the top recipient of investments in the MENA region. Egypt was the top recipient with 17% since 2006 reaching 12% in 2012 and coming third after Morocco and Lebanon. This shows a significant effect after the 25th of January revolution and the aftermath of political and economic turmoil. It might also be a result of the slowdown for privatisation opportunities. Figure (3.8) shows the split of investments since 2006 and the current situation in 2012.

Figure (3.8): Regional split of investment volume

Since 2006 Since 2012



Source: MEPEA (2013): Zawya Private Equity Monitor

Concerning the sectors of investment of the PE industry in the MENA region, there is a dramatic shift towards the IT sector in the region. Since 2006 the share of the investment to the IT sector was a mere 15% which reached a staggering 40% of all PE/VC investments in 2012 where 35 out of 36 investments where venture capital in nature (MEPEA, 2013). This is an outcome of the decline in buy-outs and larger deals in the region, however, it still signals a healthy component in the development of the region's economy. In 2006, the Middle-East Economic Digest stated that the majority of the industry is inclined towards late stage financing (PE) with the real estate sector attracting the majority of the funds. The article showed that there is a need for other investment opportunities and that the market will shift towards venture capital (MEED, 2006). The construction sector had the most declines from 9% since 2006 to a negligible contribution. The industrial manufacturing decreased from 12% to 9% during the same period while the remaining sectors were snot highly affected.

3.10 Summary

Egypt is facing many political and economic challenges. The escalating issue of unemployment remains one of its biggest problems. However, promoting entrepreneurship among the large numbers of its youth population can be seen as an opportunity and part of a solution to its economic burdens and high unemployment. Many hurdles in the business environment and regulations might not be supportive to an entrepreneurial ecosystem. Cumbersome regulations to start and dissolve a business are present; low enforcement of law, corruption, and low economic freedom among other constraints might obstruct the development of entrepreneurship in Egypt. On the other hand, positive perception on entrepreneurship and low fear of failure in Egypt are positive indicators that might help increase entrepreneurial activities. Lack of sufficient education, training, apparent gender gap and lack innovation seems to be among the major impediments. Despite the charitable and cooperative nature evident in ‘love money’ support to entrepreneurs, a finance gap to SMEs and start-ups is still a major aspect hindering new business formation and growth of existing businesses. The government of Egypt aware of this important obstacle introduced a package of reforms for the financial sector with an emphasis on SME financing. The banking sector and debt financing are slowly developing through SME lending, leasing, factoring as well as the supporting activities of credit guarantee and credit rating. Other initiatives such as the SFD is also playing an important role to the MSEs, however medium size and equity financing is beyond its scope. The introduction of the NILEX and the recently established BEDAYA fund were introduced by the government to support in equity financing to SMEs among the efforts initiated to foster entrepreneurship and promote venture capital as a contributor to entrepreneurial finance. The unprecedented liquidity caused by record oil prices accompanied by the private wealth of high net worth individuals in the Gulf contributed to the growth of a PE industry in the MENA region with large share in Egypt. The fact that the appetite for VC firms is increasing and inclining towards high growth technology based ventures with the compliance of the VC concept with Islamic finance, which is gaining a great momentum in the region, are all in favour of a vivid VC industry in the region and Egypt. This research explores entrepreneurial finance in Egypt and the opportunities for its development with a deliberate focus on the venture capital industry as a prospect component towards entrepreneurship development and supporting HGEs in Egypt. In doing so, this study adopts an institutional theory framework to analyse entrepreneurial finance and VC respectively. The coming chapter is the theoretical framework, then the research methodology, followed by the analysis of the findings and further discussions.

Chapter 4: Theoretical Framework

4.1 Introduction

This thesis explores the situation of entrepreneurial finance and venture capital in Egypt and thus relevant organisation-environment theories would be a plausible theoretical foundation fitting the structure of this research. It is important to take into consideration the compatibility and the applicability of those theories to emerging economies. It is imperative to take into account the distinctive characteristics and changing nature of emerging economies and therefore choose a framework that would give a comprehensive explanation on both the macro-level and firm-level. The general environment is of high essence to this research, specifically in regard to the economic, social, cultural, and legal context. According to Hatch (1997), the most influential theories that are capable of explaining the relationship between organisations and the environment are resource dependency theory, population ecology, and institutional theory. In addition, Pfeffer (2003) considered these to be the three important theories on organisations and their environment as they all share in common the emphasis and importance of the surrounding environment. The differences between the three are mainly in the level of analysis and the degree of influence of organisations on the environment and vice versa; whether organisations are passive in their environments or they are the shapers of this environment.

It is worth mentioning that in this chapter the use of theoretical foundation is for data analysis purposes and not as an explanatory theory. Thus, the use of institutional theory and its categorisation (elaborated in section 4.4) was found to be most suitable as an analysis framework most appreciated for data presentation and analysis of findings in chapters six and seven. The use of institutional theory framework in a similar manner was utilised largely in studies on entrepreneurial finance and VC

(Bruton, Ahlstrom and Singh, 2002; Isaksson, Cornelius, Landstrom and Junghagen, 2004; Wright *et al.*, 2005b; Scheela and Van Dinh, 2004; Zacharakis, McMullen and Shepherd, 2007; Bruton *et al.*, 2010; Valdez and Richardson, 2013) (Further discussions in section 4.5).

The following section introduces the three most influential theories, namely resource dependency, population ecology, and institutional theory, followed by the rationale for adopting the institutional theory framework. The chapter then focuses on institutional theory and its categorisation, highlighting the previous research adopting the same framework, then the gap in literature, research questions, and finally the research direction.

4.2 Theoretical Foundation

A brief introduction on resource dependence theory, population ecology, and institutional theory is essential to consider their fitness to this research. First, resource dependence theory argues that the organisation is strongly connected to the external resources of the environment, such as capital, raw materials, labour, equipment and knowledge, and by being able to understand these factors, it helps overcoming the dependency on them (Barney, 1991). This makes organisations vulnerable if they are highly dependent on their external resources, however, understanding and overcoming such vulnerability is argued to be the most important advantage of this theory (Hatch 1997). The essence is that organisations do need resources; financial, physical, information, which are all acquired from the environment and therefore dependent on external resources (Pfeffer, 2003; Pfeffer and Salancik, 2007). On the other hand, population ecology theory studies the patterns of success and failure of organisations while they compete for their resources (Hatch, 1997). However, similar to resource dependence theory, population ecology views organisations as dependent on the environment. According to Pfeffer (2003), resource dependence theory and institutional theory differ in how they deal with environmental determinism, strategic choices, and connections between external and internal dynamics, yet both theories are growing close together. Some researchers combine resource dependence theory and institutional theory, such as on sustainable competitive advantage (Oliver, 1997), and on studying organisations such as large law firms (Sherer and Lee, 2002), and on SMEs export choices (Hessels and Terjesen, 2010). Moreover, according to Greening and Gray (1994), in their paper testing a model of organisational response to social and political issues, there are some complementarities between the resource based theory and institutional theory, however, they are distinct on the extent of influence of managerial decisions on the environment.

Within the scope of this research, resource dependence theory would explain how vulnerable and dependant entrepreneurs and entrepreneurial finance are on the resources of the environment, however it will not be able to explain other effects from a broader perspective such as cultural and normative perspectives which remains of essence to the objective of this research. Also, as the level of analysis of resource dependence theory differs from both population ecology and institutional theory since it focuses on the organisational level while the latter focuses on the environmental level (Hatch, 1997). This also remains an important factor for this study where both the environmental and firm level are both fundamental.

In respect of population ecology, a group of scholars, Hannan, Freeman, Carroll and others lead initiatives to study a population of organisations' collective behaviour, their origins and their evolution. Literature has evolved to shape a contour of this discipline in the emergence of theory fragments such as; organisational forms and population (Hannan and Freeman, 1989; Hannan and Carroll, 1992), structural inertia and change (Hannan and Freeman, 1984), age dependence (Freeman et. al. 1983), density dependence (Hannan and Freeman, 1988), niche structure (Freeman and Hannan, 1983) and resource partitioning (Carroll, 1985). It might have been conceivable to use organisational ecology theories in this research; however, first assumptions would show that the newness of entrepreneurial finance and VC industry in Egypt and the insufficient sample of the population were not supportive for such analysis. Moreover, the low level of ‘technical development' of the VC industry in Egypt and the influence of institutional determinants on the financial services sectors incline towards the use of institutional theory. Hatch commented on the constraints of using population ecology: *"There are several constraints on the usefulness of the population ecology view. First, as with Darwin's theory, the definition of fitness is a problem.....we only know survival when we see it. Second, the theory applies most readily to populations that are highly competitive....When competitiveness is compromised by existence of enormously powerful organisations or barriers to entry or exit, the population ecology model loses much of its explanatory power. In these circumstances the institutional view is helpful."* (Hatch, 1997; p.83). Finally, population ecology concentrates on the *"technical, physical and economic sectors"* while the institutional theory *"focuses on the influences associated with social, cultural, political and legal sectors"* (Hatch, 1997; p.87), which is found to be more appropriate for explaining the case of entrepreneurial finance in Egypt.

4.3 Introduction to Institutional Theory

Institutional theory is divided by many to 'Old' and 'New' institutionalism, according to Selznick (1996). Selznick (considered the father of the institutional theory (Hatch, 1997; 83)) argued that such categorisation is not adequate and that this might inhibit the theory to contribute to major issues. Nevertheless, he respected the work by DiMaggio and Powell (1991) in his argument on their notion of "new institutionalism"; however, he suggested a reconciliation of the old and new institutionalism and was against the labelling issues. The neo- institutionalism (as been generally identified) can be clearly viewed in the work of Zucker, DiMaggio and Powell and the work of Richard Scott, as they added the cultural and social dimension as significant factors to institutionalisation (Hatch, 1997). Institutional theory explains the influence of institutions on individuals and organisations and how their reactions are shaped by such influence (DiMaggio and Powell, 1991; Scott, 1995). Contrary to the tenets of population ecology, why there are many different kinds of organisations, Institutional theory tries to answer why they are similar (Hatch, 1997). DiMaggio and Powell (1983) argued that these institutional forces influence organisations to act the same and look quite similar in a notion called 'Institutional Isomorphic Change'. Then they identified three mechanisms that lead to this 'isomorphism', *"coercive isomorphism that stems from political influence and the problem of legitimacy, mimetic isomorphism resulting from standard responses to uncertainty and normative isomorphism, associated with professionalization"* (DiMaggio and Powell, 1983; 150). On the other hand, Scott categorised the institutional influences into normative, regulatory and cognitive (1995). Where the normative forces resembles the norms and the values in a society, the regulatory indicates the rules, laws and regulations and the cognitive reflects the cultural dimension of the society. Scott (1987) has also argued that there is a process of "institutionalisation" within environments and that they differ in this degree of institutionalisation.

The use of institutional theory in emerging economies is not novel (Hoskisson, Eden, Lau and Wright, 2000; Bruton *et al*., 2005; Wright, Filatochev, Hoskisson and Peng, 2005a). The same institutions in different countries and societies would cause a different economic outcome and therefore institutions play a significant role in a country's economic activities (North, 1990). The behaviour of businesses in different countries could be explained by government policies, and common shared knowledge and culture (Kostova, 1997). Accordingly, institutional theory could be seen as a more appropriate analytical lens than pure economic theories for the analysis of markets in emerging economies (Bruton *et al*., 2005). Moreover, from an institutional theory perspective, current determinants in an industry, among economics, are the formal and cultural institutions that influence its economic activities (Bruton *et al*., 2010). In addition, Wright *et al.* (2005a) found that the most dominant theory used in emerging economies' strategy research was institutional theory and they referred this to its capability to explain the cultural dimension which rises to be a significant factor in those countries. According to Hoskisson *et al.* (2000) many researchers argued that Institutional theory is the most appropriate method of analysis in emerging economies, due to the facts of the changing environment and economic growth in emerging economies which makes it a good opportunity to 'capture' institutional changes. They added that institutional theory explains the impact of regulatory bodies on organisational behaviour and on the economic performance, and it can also be effectively used to analyse transition economies. According to Ramamurti (2000), transition economies are characterised by low personal savings, low property rights, weak financial system and legal systems. Since all this criteria fit the Egyptian economy, and though it is usually characterised as developing and not transitional or emerging, yet the criteria is still applicable due to apparent similarities.

4.4 Categorisation of Institutional Theory

According to Scott (1995), institutional forces can be grouped into three main categories: normative, regulatory and cognitive institutions. In this research the neo-institutional analytical frame work developed by Scott (1995) will be employed to group the influential institutional pillars and reflect on them in the analysis. The framework will also enable better understanding of the effect of each group on the status of entrepreneurial finance and VC industry in Egypt rather than analysing each institution individually. It also assists in a better analysis of the different determinants and the multiple effects of different institutions. Such categorisation has been effectively used before such as the research by Bruton *et al*. (2002; 2005) and in the multi-country empirical study by Valdez and Richardson (2013) researching entrepreneurship on a macro-level. Table (4.1) illustrates the characteristics of the three pillars: normative, regulatory, and cognitive on the basis of compliance, order, and legitimacy. According to Scott (1995), such categorisation should be dealt with in the form of a conceptual framework within institutional theory and not as a theory on its own.

Table (4.1): Characteristics of the Three Pillars of Institutions

	Characteristic		
Pillar	Regulative	Normative	Cultural-cognitive
Basis of compliance	Expedience	Social obligation	Taken-for-grantedness Share understanding
Basis of order	Regulative rules	Binding expectations	Constitutive schema
Mechanisms (of control)	Coercive	Normative	Mimetic
Logic	Instrumentality	Appropriateness	Orthodoxy
Indicators	Rules Sanctions Laws	Certification accreditation	Common beliefs Shared logics of action
Basis of legitimacy	Legally sanctioned	Morally governed	Comprehensible recognizable Culturally supported

Source: Scott (1995)

4.4.1 Regulatory Institutions

Regulatory institutions are the legal and governmental institutions that regulate the industry (Scott, 1995). They are mostly the reward and punishment policies applied by governments based on economical incentives; they contain regulations, industry agreements, and industry standards (Scott, 2007). As an example of research of the significance of this pillar on entrepreneurial finance, is the work of Li and Zahra (2012) on the effect of formal institutions on the development of VC industries. Also, Baygan and Freudenberg (2000) highlighted the role of governments in encouraging risk taking investors. The importance of regulatory institutions and their development on different industries is present in its formal institutions initiated by its governments. According to McMullen, Bagby, and Palich (2008), it is evident that economic policies and regulatory matters as well as incentives do affect the decision to launch new ventures in different economies. In this particular research the regulatory institutions are commercial law and its enforcement, the Egyptian financial supervisory authority (EFSA), General authority for investment (GAFI), and all other laws and regulations affecting entrepreneurship and entrepreneurial finance. In addition for what is regarding venture capital firms, specifically, the fund's legal setup and fund management firms regulations. The taxation system and its affect on the entrepreneurial finance system especially capital gain tax; as well as the intellectual property rights (IP) and how this is affecting the industry. Furthermore, it addresses the general requirements and regulations on investment decisions of entrepreneurial financiers. In addition it covers the laws regulating SMEs and investee firms in Egypt such as company formation and other legalities. Moreover, laws affecting the exit strategies, especially, dissolution and bankruptcy laws will be taken into consideration. The issue of bankruptcy laws are highly accountable in promoting entrepreneurship due to the effect they have on low fear of entry and repeated ventures creation and consequently on venture finance and the VC industry as a whole. Bruton *et al*. (2005) have discussed this institutional force and its differences among different economies and how it affects the industry under research. This institutional determinant will be affecting entrepreneurial finance activities as well as both the macro and micro perspectives on opportunities of VC industry to develop and the investment behaviour of the current VC firms.

4.4.2 Normative Institutions

Normative institutions indicate what is appropriate and what is acceptable within a certain society or industry reflecting values and norms to conform to others (Scott, 2007). They are the professional's norms and common practices in the intended industry or profession (Bruton *et al*., 2005). Regarding entrepreneurial finance in Egypt, the effect of associations and organisations assisting entrepreneurs whether financially or non-financially would be of importance to this pillar. In addition, the societal acceptance of entrepreneurship and preference of certain financial tools over others as well as the cooperative nature among family members are all taken into account. Regarding the venture capital industry, it is argued that such norms are carried on from common practices of the early professionals in the industry (Bruton *et al*., 2005). In addition, since the early practitioners of the venture capital industry were in the United States, the United Kingdom and Europe, therefore there is a great influence of their norms and customs on the industry worldwide (Bruton *et al*., 2005). Moreover, most of the VC professionals have worked, learned or trained in western countries and therefore they will have to carry those norms to their countries. Researchers demonstrated that this was valid in the Asian VC market (Bruton *et al.*, 2005) as well as the Latin American VC market (Bruton *et al*., 2009). In this research, it is of importance for the research's outcome especially on VC investment behaviour and the firm level analysis. This institutional determinant will also affect the stage of financing, fundraising, sector of investment, and deal selection. The effect of VC associations in the region such as MENA private equity association (MEPEA), Gulf venture capital association (GVCA), and Arab private equity association (APEA) will be taken into account. The Egyptian private equity association was formed in 2010 to be the body representing private equity and venture capital in Egypt. Also the fact that the association is still nascent and has recently started its activities and how this is shaping the industry is taken into account. The formation of this association will contribute to the norms of the industry and therefore will be a normative force to be captured in this research.

4.4.3 Cognitive Institutions

These are the individual behaviours imbedded by cultures and beliefs in different societies; they represent the actions on the individual level in respect of such beliefs (Scott, 2007). Cognitive institutions are the result of the culture of the society where the industry is analysed (Bruton *et. al*, 2005). The cognitive pillar is different from the normative, as the normative reflects the collective behaviour of the society while the cognitive is what individuals believe and thus act upon (DiMaggio and Powell, 1983). Researchers have emphasised the role of the cultural dimension on both entrepreneurship and innovation activities (Hayton *et al*. 2002). In fact, the cultural perspective is argued to be an essential component in economic process (Lavoie and Chamlee-Wright, 2002) thus generates an understanding of the interconnectedness between culture and economics (Chamlee-Wright, 2002: p.18-19). Chamlee-Wright (2002) argue that the Austrian school of economics thought accounts for market decisions as a reflect of a complex personal interpretation of the decision makers based on the past experience, language, and culture and thus gives a cultural analysis to market processes and a better understanding for the field of entrepreneurship.

Regarding the case of entrepreneurial finance and VCs in Egypt as part of the MENA region, one would expect a significant effect of this institutional force. It is important to capture the topics relevant to the cultural values and beliefs on entrepreneurship and entrepreneurial activities in general and on a cooperative society such as Egypt. The dimension of Shari'a law compliance and its effect on fundraising and investments are separately addressed and highlighted as a significant component of the MENA region and Islamic societies where Egypt belongs. Another dimension is family values which are clearly found in family owned enterprises and the acceptance of VC investment and partnership concepts in general. The cultural and moral codes governing the VC-Entrepreneur relationship is also of importance. The effect of social networks, reputation, and trust issues in investment selection will also be investigated as a major differentiating aspect of VCs behaviour worldwide.

In the scope of venture capital, Bruton, Fried and Manigart (2005), identified global differences between developed and emerging economies regarding the cognitive dimension. Bruton, Ahlstrom and Singh (2002; p. 205) identified those cultural forces in VC industries as *"moral codes, expectations of trust and reliability, the importance of non-contractual relationships and connections, regard for government and public sector priorities, and expectations of government support"*. Also it was found that the investment decisions of VC investors are influenced by the personality and cognitive structures of the VCs (Lim *et al*. 2010). Moreover, Li and Zahra (2012) identified two cultural determinants and their effect on VC development; they specified uncertainty avoiding societies and collectivist societies as the main cultural influences. According to Valdez and Richardson (2013), normative cognitive power was found more descriptive on macro-level entrepreneurship than the regulatory and legislative power. In summary, the cultural cognitive institutional determinant is of high significance to this research, it affects the entrepreneurship environment as well as the financial tools involved all through the investment decisions and investment cycle. The cognitive power is a major differentiating determinant across countries and thus in the MENA region and consequently Egypt with all the distinctive cultural characteristics in this part of the world.

4.5 Institutional Theory and Entrepreneurial Finance

Institutional theory as an analysing lens gives an opportunity to test all the influential institutional forces, especially the cultural dimensions, to assess the current situation of entrepreneurial finance, a potential VC industry, and the investment behaviour of entrepreneurial financiers. Also it helps evaluate the institutional development in Egypt compared to regional and global economies. The utilisation of institutional theory is rapidly increasing and becoming a popular foundation in entrepreneurial research where it has proven to be helpful (Bruton *et al*., 2010) and to assess the institutional determinants of macro-level entrepreneurship (Valdez and Richardson, 2013). There is a growing body of researchers utilising the institutional theory to analyse entrepreneurial finance and specifically the venture capital industry. For example the research by Isaksson, Cornelius, Landstrom and Junghagen (2004) on the contracting issues in the Swedish VC industry and their findings were conforming to the institutional theory since there were little differences between experienced and inexperienced VC firms in their contractual choice. In respect of international VC comparisons, Wright *et al.* (2005b) suggested that there is an important need for an institutional perspective to analyse development of VC industries and the behaviour of VC firms across countries. In this manner, on VC research in emerging economies specifically in Asia; Bruton, Ahlstrom and Singh (2002) researched VC in Singapore and found that the government (regulatory influence) has an important role in shaping the VC industry. In addition, Bruton and Ahlstrom (2005) studied VC in China to find that institutional influences affected VC actions along the VC cycle. Scheela and Van Dinh (2004) on the case of Vietnam identified major differences between the US and Vietnamese VC industry due to lack of fully-developed institutions. Zacharakis, McMullen and Shepherd (2007) also examined the institutional influences on VCs' decision making in South Korea and China compared to VCs in the US. Moreover Bruton *et al*. (2005) on VC worldwide expansion, developed several prepositions testing the differences of behaviour of the VC industry in emerging economies, namely in Asia, compared to the US guided by institutional forces and Scott's categorisation. Similarly, Ahlstrom and Bruton (2006) studied VC and emerging markets while they focused on the value of networks and institutional changes in the Asian economies. Ahlstrom, Bruton, and Puky (2009) also utilised the institutional theory in examining the VC industry in Latin America and Asia to examine the impact of institutional clusters on the venture capital in those emerging economies. Furthermore it was employed on the case of Russia as an economy in transition, and how high growth enterprises could prosper in rapid evolving institutional changes (Ahlstrom and Bruton, 2010).

4.6 The Gap in Literature

Although there is a growing literature on entrepreneurial finance and the worldwide VC expansion and VC behaviour in emerging economies, it is apparent that many regions in the world are still under researched. Till the early 2000s, there was 'virtually' no research on VC in Africa, Latin America and Oceania (Bruton *et al*., 2005). Since then, there has been a sparse academic literature on the MENA region concerning entrepreneurial finance or venture capital. Apart from the difficulty or unavailability of data, such lack of research might reflect the underdevelopment or even sometimes the absence of a VC industry in the mentioned regions. Regarding the demand side of entrepreneurial finance represented in entrepreneurs, the Global Entrepreneurship Monitor (GEM) published annual reports including the MENA region and a specialised report on Egypt by Hattab (2008). Some academic research addresses the topic from different angles. Eid (2005; 2006) researched entrepreneurship and entrepreneurial finance in MENA region, with a public policy approach. In regard to Egypt, El-Said *et al.* (2013) address SMEs in Egypt and focus on access to finance from a banking perspective. Hassan (2010) has published an explanatory paper on PE/VC in emerging economies with evidence from Egypt. However, her work inclined towards the PE industry and late stage financing. Also data was gathered in 2005/2006 where the industry was in its very early stages and was heavily relying on PE and late stage financing. Moreover, Hassan and Ibrahim (2012) explored further the provision of financial information and its impact on the relationship between executives and venture capital managers in a study of the private equity market in Egypt. Therefore, once more, it is in many ways different to this research as being solely on the firm level, topic specific, and with high reference to late stage PE industry. There were other topic specific research on PE/VC industries in North Africa, such as the work by Hearn (2014) assessing the impact of institutions, ownership structure, business angels, venture capital and lead managers on IPO firm under-pricing across North Africa, he gathered a sample set of 86 IPO firms from across North African equity markets, namely Egypt, Morocco, Tunisia and Algeria from 2000 to 2013. Furthermore, Montchaud (2014) explored the interest of PE/VC financing mode for supporting entrepreneurship in Africa, in reference to Morocco and South Africa. Montchaud (2014) argued that PE/VC industries could be improved to support SMEs. Moreover, some of the VC/PE associations and professional institutions are publishing professional reports in collaboration with business schools such as INSEAD with PWC in 2011 and INSEAD with Booz & company in 2010. Also annual analytical reports are published by MENA PE association, sometimes in collaboration with the British venture capital association (BVCA). The former set of reports was found beneficial mostly in assessing the magnitude of PE/VC industries in Egypt and MENA region. Regarding policy dimension targeting SME financing, there are a series of reports by the Organisation for Economic Co-operation and Development (OECD) in business climate development strategy in MENA region (2008) with partial focus on SME policy and promotion (2010). In addition, there is an electronic platform issuing data on the industry such as Zawya.com and on entrepreneurship in general such as wamda.com.

Accordingly, it is a plausible assumption that there is a gap in academic literature for the concerns of entrepreneurial finance and VC/PE industry in Africa and the MENA region in general, and entrepreneurial finance and the VC industry in Egypt in particular. This research focuses primarily on early stage entrepreneurial finance covering the different available tools such as business angels, crowdfunding and venture capital in Egypt. It tests the effect of institutional determinants on shaping the domain of entrepreneurial finance and the propensity of developing a VC industry. Also it captures the Egyptian entrepreneurial environment during and after the January 25th revolution that took place in 2011 where the socio-economic and political environment in Egypt was heavily influenced. One can assume that this thesis is one of the early academic researches undertaken in Egypt as well as the Arab MENA region that focuses on early stage entrepreneurial finance and venture capital. Also, most of the professional bodies and industry associations concerning PE and VC were formed and started publishing data research from 2006 onwards as the industry started to grow. This positively affects the research for accessibility of this secondary data and also helps in validating the findings.

4.7 Research Questions

This research explores the current entrepreneurial finance domain in Egypt, it further explores the opportunity for a VC industry to grow and help develop the Egyptian economy. Other research earlier discussed shows the common themes affecting the development patterns of VC industries worldwide. It also highlights the differences in international VC firms' behaviour and hence generates knowledge on international practices. Accordingly, analysing influential institutional determinants composing the entrepreneurial finance environment and VC industry in Egypt from an Institutional theory perspective prevails to be necessary. However, the research earlier discussed would lead us to believe that institutional development in a certain country improves its entrepreneurial activities and VC industry in different economies. This is explored in this research which leads to the main research question.

The main research questions will be as follows:

<u>First Question</u>: What are the main institutional determinants shaping entrepreneurial finance in Egypt?

1.1- What are the major constraints facing the development of entrepreneurial finance in Egypt?

1.2- What are the conducive factors supporting the development of entrepreneurial finance in Egypt?

<u>Second Question:</u> What is the prospect for the development of a venture capital industry in Egypt?

2.1- What are the current institutional forces supporting the growth of a venture capital industry in Egypt?

2.2-What are the current institutional forces encumbering the progression of a VC industry in Egypt?

The first question explores the current situation on entrepreneurial finance in Egypt. It examines the environment of entrepreneurial activities and available sources of finance. In this question the institutional determinants will be the main examining lens, what are the main determinants, and how do they shape the field of entrepreneurial finance in Egypt. Moreover, the sub question is on the major hurdles affecting access to entrepreneurial finance. This question pinpoints the major obstacles facing access to finance and how are they shaping the current dynamics of entrepreneurial finance. The second sub question is on the conducive factors supporting the development of entrepreneurial finance. The first question is answered in chapter six, the first part of the chapter looks at the general context on entrepreneurial finance in Egypt and the second part of the chapter applies the institutional framework and its categorisation on the findings.

The second question explores the opportunity for a VC industry in Egypt. It explores the current situation of the VC industry and the propensity of this industry to contribute to entrepreneurial finance and the development of the Egyptian economy as a whole. Also it suggests whether the industry has the capability to grow in the first place under the current policies, regulations, and surrounding environment. This leads to the sub questions on the institutional development with the three pillars of regulatory, normative, and cognitive dimensions. This part aims to address the institutionalisation of the industry in the case of Egypt and the constraining and supporting factors shaping the industry's development and affecting its growth. It will also assess the institutional determinants on both the supply side, i.e. the VC firms, and the demand side of potential ventures and barriers to entrepreneurship, as well as the surrounding environment comprising of industry professionals, all in the light of norms, culture, and regulatory institutions. The second question is answered in chapter seven, similar to the first question, the first part is the general overview on the VC industry in Egypt and the second part is further analysis using the institutional theory lens.

4.8 Research Direction

The value of entrepreneurial finance is indispensable for a country that seeks to promote entrepreneurship (Lerner, 2009). The VC industry has proven itself as an integral component of entrepreneurial finance (Dennis, 2004) and therefore a favourable factor stimulating economic growth (Jeng and Wells, 2000). Venture capital industries' growth patterns differed from one country to another (Wright *et al*, 2005b). This exploratory study helps generate an understanding of the current situation of entrepreneurial finance and the VC industry in Egypt, as part of the MENA region. This study examines the VC industry's growth potential in Egypt and its capability to contribute to the development of the Egyptian economy. Moreover, it seeks explanations for the growth pattern of the industry; what is inhibiting the industry's development and what can be done to enhance its growth pace. Using institutional theory as the lens for analysis is found stronger due to the nature of this research and the market where the analysis is undertaken. This study assesses the effect of the institutional forces shaping entrepreneurial finance in Egypt and on the development of the VC industry. The effect of the Arab spring and its aftermath on Egypt and the whole region, and its effect on entrepreneurship are of value to this research. To be able to answer the research questions, the following chapter on methodology explains the rationale and justification on research methods, data enquiry, and data analysis. In brief, a qualitative approach takes place due to the lack of quantitative data and the exploratory nature of this research. A combination of participant observations and in-depth interviewing with the major stake holders of entrepreneurial financiers and VCs in Egypt is believed to create both the depth in knowledge concerning the industry and the breadth needed to comprehend the whole topic. The research then answers the research questions on the institutional determinants shaping the current situation of entrepreneurial finance and venture capital in thorough analysis and discussions. The effect and magnitude of Islamic finance and its fitness in the scope of venture capital is also examined.

Chapter 5: Research Design and Methodology

5.1 Introduction

The objective of this research is to generate an understanding on the current status of entrepreneurial finance in Egypt, while exploring the opportunities for a prospective venture capital industry. To understand the reasons behind the current position of the VC industry, it must be appreciated that it is still in its cradle, and a viable and sustainable course for its growth needs the support of all stakeholders. Moreover, it is vital to highlight the obstacles that might inhibit its development. This research chooses Institutional theory as a lens for analysis providing an opportunity to test all the influential institutional forces, especially the social and cultural dimensions. This provides a framework to assess the current situation of the entrepreneurial finance in general and the VC industry in specific; in addition to its investment behaviour and evaluate its development in the light of regional and international markets. Furthermore this research focuses on the roots of the rationale behind the current entrepreneurial finance position and VC structure in Egypt. Also it highlights the cultural dimension and other distinctive characteristics of the Egyptian market and economy. As a result, to be able to acquire such knowledge this research was designed as an exploratory research, with a qualitative method, and following a grounded approach in data gathering and analysis. It should be well noted that this research is not intended to formulate a theory; the benefit of the grounded approach, in a similar manner to grounded theory, to this research is in its methods to uncover phenomenon and process rather than theory formulation. Thus it proves to be most valuable in data gathering process. Hence, the research methodology allows themes and concepts to emerge from the data without predetermined conclusions. In this chapter the detailed rationale behind the research design and methodology is provided.

5.2 Research Design

According to Sekaran (2003), an exploratory study is appropriate when little research is undertaken and not enough information is available for the researcher. Sekaran added that this might as well be the case when some facts are known but still a great deal of information is needed to set a theoretical framework. She highlighted the importance of intensive interviews to get an idea of the situation and understand the phenomenon. All of which perfectly fits the situation of entrepreneurial finance and VC industry in Egypt. Moreover, most of the studies taking place in emerging economies followed the same exploratory route due to insufficient data in those regions and the little knowledge on entrepreneurial finance in developing and emerging economies, such as the work on the Asian venture capital industry by Bruton, Ahlstrom and Singh (2002), Bruton and Ahlstrom (2003), Scheela and Van Dinh (2004), Bruton, Fried and Manigart (2005), and Ahlstrom and Bruton (2006).

Accordingly, this research will take a qualitative, exploratory approach in the form of the traditional style of 'one coherent research' format. The research will adopt a pure naturalistic-qualitative strategy using 'Naturalistic inquiry' method to collect 'qualitative data' in order to perform 'content analysis'. Naturalistic enquiry studies real world situations as they unfold naturally; with openness to whatever emerges and no predetermined constraints on findings (Patton, 2002). The purpose of the study is to understand the nature of entrepreneurial finance and the VC market and the behaviour of VC firms in Egypt and the problems facing the industry. In addition, this research uses Institutional theory as a conceptual framework to assist in the analysis of the current situation on entrepreneurial finance. Thus the study could be of support to financiers, VC professionals, and policy makers in the region and help provide policy suggestions. This criterion is in line with the 'Applied Research' concept implemented in this thesis. There are two types of business research; applied research and basic research (Sekaran, 2003). Applied research contributes to knowledge on a human or societal problem and thus helps in understanding the nature of the problem and interventions to solve this problem; while basic research generates a body of knowledge as an end in itself contributing to theory to understand and explain how the world operates (Patton, 2002). The units of analysis are 'structure focused' in the form of organisations and institutions and in the same time 'geography focused' in studying the case of Egypt as part of the MENA region.

5.3 Grounded Approach

"Most qualitative methods allow researchers to follow up on interesting data in whatever way they devise. Grounded theory methods have the additional advantage of containing explicit guidelines that show us how we may proceed" (Charmaz, 2006: p.3). The grounded theory approach was developed by Glaser, Strauss, Corbin, and Denzin, among other founding scholars (Patton, 2002). It focuses on the process of generating theory, emphasising the steps, inductive and deductive constant comparisons, doing theoretical sampling, and testing the outcomes with additional fieldwork (Patton, 2002). It studies the phenomena closely and is grounded to the real world to generate alternative explanations via rigorous analysis. According to Cassell and Symon (2004), the data sources for grounded theory are interviews, participative observation, and analysis of documents. They added that such data is used for triangulation in grounded theory and it evolves from the emerging themes and concepts, until 'theoretical saturation' is reached. The grounded theory starts with no 'predetermined conceptual framework or theory'; however, it focuses on uncovering phenomenon and processes (Cassell and Symon, 2004). Contrary to the classic

grounded theory based on the work of Glaser and Strauss, Charmaz (2006) argues that neither data nor theories are discovered as emerging from the data separate from the scientific observer. She added that we are part of the world we discover and the data collected; thus, constructing grounded theory is through past and present involvements and interactions with people, perspectives, and research practices. *"Grounded theory guidelines describe the steps of the research process and provide a path through it. Researchers can adopt and adapt them to conduct diverse studies. How the researchers use these guidelines is not neutral; nor are the assumptions they bring to their research and enact during the process."* (Charmaz, 2006: p.9). This research is not intended to formulate a theory, the benefit of the grounded approach to this research is in its methods to uncover phenomenon and process rather than theory formulation. Thus it proves to be most valuable in data gathering process. Thereby, using a conceptual framework and theoretical framework of institutional theory for analysis purposes for this research is not contradicting to grounded theory guidelines. The research methodology still allows themes and concepts to emerge from the data without predetermined conclusions. *"Theory is a spotlight. A useful theory illuminates what you see. It draws your attention to particular events or phenomenon, and sheds light on relationships that might otherwise go unnoticed or misunderstood"* (Maxwell, 2005: p.43). In a comparable manner, field studies with a similar approach to grounded theory research design and an institutional theory framework were used in analysing entrepreneurial finance, specifically the VC industries in Asia by Bruton, Ahlstrom, and Singh (2002) in Singapore by Bruton and Ahlstrom (2003); in China by Brutonn Ahlstrom and Yeh (2004) in East Asia, and by Ahlstrom and Bruton (2006) on networks and institutional change in East Asia. It has also been used by Bruton, Ahlstrom, and Puky (2009) in a comparison of VC industries of Latin America and

Asia. This research followed the same track of field study and data gathering in a manner similar to grounded theory; it took place between 2008 and 2013 to establish the current situation on entrepreneurial finance and VC industry, tracing it back to its origins and testing the institutional determinants.

The researcher used the three sources of data that are often used in grounded theory; namely, interviews, participative observation, and analysis of documents. The in-depth face-to-face interviews included the main stake holders of entrepreneurial finance domain in Egypt including existing VC firms' executives in Egypt. In addition, government officials and policy makers were interviewed to understand the reason behind the current regulatory institutions. Also a sample of entrepreneurs in Egypt covering different industrial sectors, sizes and growth stage was used to examine the demand side of the VC industry in Egypt. Furthermore, industry professionals and financial consultants were interviewed for an unbiased opinion and triangulation. Regarding the participative observant method, the researcher had access to a business association where he participated and advised SME financing initiatives and thus allowed him to first hand 'complete participant' in the domain. In addition, other data were gathered at conferences and roundtables attended by the researcher that were relevant to the VC/PE whether global, regional or local (Egypt) to get an idea of the industry's magnitude and direction. Documents provided by NGOs, Associations, professional, and academic bodies were gathered and will be analysed among other data acquired.

5.4 The Qualitative Approach

Among other advantages of the qualitative approach, it is highly beneficial in exploratory studies in particularly when research objectives require in-depth analysis and why questions are the most important. *"If a concept or phenomenon needs to be understood because little research has been done on it, then it merits a qualitative approach"* (Neuman, 2005: p.22). Specific to this research, there are four more reasons for choosing qualitative methods over quantitative methods. First, is the relative newness of the industry in Egypt which is in the range of ten years or less. Thus quantitative analysis relevant to performance of VCs and tracking VC backed firms' performance or post IPO performance are not feasible. Second, the number of firms in the VC industry in Egypt is also relatively small, less than 15 actively operating firms where less than five are early stage VCs and the rest are PE which demonstrates infeasible of a population analysis. According to Wright *et al*. (2005b), small numbers of VCs in emerging markets disables industry analysis using multivariate techniques. Third, the general opaque nature of small and entrepreneurial ventures as well as of the VC/PE industry worldwide where obtaining financial data is highly problematic. Thus, the private nature of VCs in general and their limited disclosure of the data do not support using archival data for the industry's behaviour analysis (Wright *et al*., 2005b). Fourth, adding to the previous points is the nature of data collection in developing countries. Data sets and databases in most of the industries, especially the VC industry, are not officially available in the MENA region. Over and above this was the absence of a VC association in Egypt to provide data and statistical figures. The Egyptian Private Equity Association (EPEA) was launched only in 2011 in the fields of private equity and venture capital. This research explores entrepreneurial finance and the nature of the VC industry in Egypt in a comprehensive and holistic manner. It also sets the initial foundation for further work on more detailed aspects of the industry and other quantitative longitudinal comparative studies. This is only possible when the industry is more mature and the number of firms increases to assess the industry's development and behaviour in the light of international markets.

5.5 Sampling Strategy

Random sampling is inappropriate for qualitative research; thus 'rich' informants are more likely to provide insight and understanding to researchers (Marshal, 1996). The two main strategies are used in data sampling; 'convenience sample' (in terms of time, effort, and money), and 'purposeful sample' (selecting the most productive sample of informants to answer research question); the former is discouraged in qualitative methods unless unavoidable (Maxwell, 2005). According to Patton (2002), purposive sampling is when a specific type and number of cases are chosen that are information rich and reflects the purpose and resources of the study. Hence, the primary sampling strategy of this research has been purposive sampling. Sub-strategies were as follows, regarding the VC firms in Egypt, 'criterion sampling' is used which is considering all cases that fit the criterion (Patton, 2002). In addition, 'chain sampling' or snowball sampling to take into consideration other VC firms that the researcher was not aware of, but been suggested by a reliable source was also applicable causing a snowball effect. Thus any firm that met the criteria illustrated ahead in this section or referred to as one was part of the Egyptian VC sample until knowledge on the topic was complete and additional information was insignificant.

The target group of this study is active licenced and un-licenced VC firms. Regarding the un-licenced, they need to be positioning themselves as purely venture capital and must be advertising themselves this way. In addition, PE firms that invest in or consider investing in early stage financing were also included in this study to assess the likelihood that they might incline toward early stage financing. Other firms or organisations involved in entrepreneurial finance, such as, Business Angels, Business Incubators and Accelerators, Crowd Funding, and hybrids between the former were included in the study. The main reason of this inclusion is to give a better understanding of the bigger picture of entrepreneurial finance in Egypt and where the VC industry fits within this picture. A pilot study *per se* was not conducted due to the already very small sample of operating VCs in Egypt.

Regarding the sample of the entrepreneurs, a maximum variation sampling is considered to capture their opinions across different industries, stages and backgrounds to observe the demand side. Additionally, VC backed entrepreneurs were interviewed to show another perception of the demand side. The sample of policy makers, industry professional and consultants was chosen upon a combination of 'stratified purposeful sampling' which shows the main characteristics of these groups to facilitate comparisons and 'intensity sampling' that chooses information rich cases (Patton, 2002).

5.6 Data Collection and Inquiry Methods

5.6.1 Interviews

A semi-structured interview or 'interview guide approach' is when topics and issues are specified; however, the wording and sequence are not and are left to the judgment and timing of the interviewer (Patton, 2002). Although it reduces the data's comparability, the interviews are conversational and situational (*op cit*.). *"It could be argued that the semi-structured interview is the most important way of conducting* *research interview because of its flexibility balanced by structure, and the quality of data so obtained"* (Gillham, 2005: p.70). Using unstructured and semi-structured in-depth open-ended interviews in the previously discussed manner with the policy makers and venture capitalists is argued (Bruton *et al*., 2002; Wright *et al*., 2005) to be the most appropriate data inquiry method for this research. In addition, unstructured interviews provide in-depth discussions and allow follow-up questions. In some developing countries questionnaires are ineffective for mailing reasons or resistance to reply (Wright *et al*., 2005). Moreover, both policy makers and VCs are hard to interview in the first place, whether because of their busy schedules or their reluctance to open up, therefore advantages of face to face meetings when arranged and approved emphasises its usage over questionnaires and surveys. In East Asia, questionnaires were not reliable, as senior managers in VC firms do not usually reply to them, over and above one must be referred by a person they trust to discuss business (Bruton *et al.*, 2002). All of which favours the utilising of in-depth, face-to-face interviews as a primary tool of data enquiry in this research (See Appendix (A) for guiding questions).

All data were recorded using a digital voice recorder and the data was often backed up by a computer. The interviews were in English and Arabic languages interchangeably. Transcribing and translating the interviews were simultaneously done and took place at earliest time possible to ensure quality of the data and avoid data crashing. Last but not least, all the data were coded in a manner to facilitate data analysis. In total there were twenty eight interviews made in this research, seven entrepreneurial financiers and VCs, ten entrepreneurs, five policy makers and government initiatives, and six financial consultants and financial industry professionals. Follow-up data were further gathered on some topics to gain more knowledge from some of the interviewees. Follow-up interviews took place through phone conversations, brief visits, and further clarifications were through emails.

5.6.1.1 Interviews with Entrepreneurial Financiers and VCs

Interviews with the Financiers including VCs were an hour to an hour and a half long; therefore it was better conducted, whenever possible, in an informal environment away from the office pressures. The interview design of the VC executives in Egypt covered the whole investment cycle (Fundraising, Investing, Value-Adding and Exit) and the effect of the three institutional categories on each phase of the cycle. An emphasis on the work by Tyebjee and Bruno (1984), Gorman and Sahlman (1989) and the work of MacMillan *et al.* (1989) (see section 2.8.3) was implicitly covered in the VCs interviews. Moreover, the interviews covered the demographic data and generic strategies of the firms such as fund size, specialisation, investment stage, number of employees, and qualifications of senior management. The interviews also covered the number of years in the business, deal completion rate, IRR, and geography. In total there were seven interviews in this set, of which only two companies with pure VC activities, one PE firm with a dedicated fund for SME financing, one PE/Holding company which is one of the biggest in the region, one VC/PE investment model, one Holding/VC investments, and one crowd funding portal.

5.6.1.2 Interviews with Policy Makers

This set of interviews was 30 minutes on average, due to the tight schedules of the interviewees. They include high level policy makers as well as senior executives in government bodies and initiatives. The interviews were performed in an unstructured manner concentrating on the general direction of the policy makers regarding entrepreneurial finance activities in Egypt and their opinion on the VC tool and how to promote it. Some of these interviews were during workshops and conferences with key figures. The five interviews with policy makers and senior executives were first with the ministry of investment, ministry of finance, Bedaya Fund, and two senior executives from the Social Fund of Development (SFD).

5.6.1.3 Interviews with Entrepreneurs

The interviews with entrepreneurs were less formal and were more structured. The focus will be as prior mentioned on the perception of VC and other tools of available entrepreneurial finance in Egypt. The set where entrepreneurs are backed with VC investments was more in-depth highlighting the VC- entrepreneur relationship. In total ten interviews took place, seven with entrepreneurs from ICT sector, retail, manufacturing, trading, and business services; and the other three were VC backed companies. The reason for the small sample is due to the availability of data from several questionnaires and reports on the same topic. The interviews made were to match the primary data gathered with the secondary data available by the Global Entrepreneurship Monitor (GEM) on Egypt and MENA which were found reliable and representative and are widely used by researchers in the domain of entrepreneurship.

5.6.1.4 Interviews with Industry professionals

The main purpose of this sample is for triangulation purposes and data validation. However, new ideas and suggestions arising from these interviews were also included in the analysis part of the research. The value of this set falls mainly on the policy recommendations part of the research and how to promote the VC industry in Egypt. Six interviews were made with three financial consultants and other industry professionals from the Egyptian Junior Businessmen Association, the Egyptian Private Equity Association, and the Egyptian Credit and Risk Association.

5.6.2 Participant Observation

"The terms 'observation', and in particular 'participant observation' usually refer to methods of generating data which entail the researcher immersing herself or himself in a research setting so that they can experience and observe at first hand a range of dimensions in and at the setting" (Mason, 2002: p.84). According to Patton (2002), fieldwork observation varies in six dimensions: the role of the observer, insider versus outsider perspective, who conducts the inquiry, disclosure of the observer's role to others, duration of observations and fieldwork, focus of observation. Reflecting the six dimensions of Patton (2002: p. 277) on this research, the researcher was a 'full participant in the setting'. He was engaged in the daily operations and meetings of the SMEs committee in the business association from which he interacted with the stake holders; entrepreneurs, financiers, development agencies, and policy makers. The researcher attempted a balanced perspective regarding 'insider (emic)' and 'outsider (etic)' perspective dominance. The researcher is an insider in the sense of the cultural dimension in being Egyptian living in Egypt, as well as a business person aware of the business environment and culture in Egypt. He was also an insider in the association where he actively examined the hurdles facing SMEs and entrepreneurs and searched for solutions to assist them. On the other hand, the researcher was aware of the research setting and made effort to maintain his outsider status as a researcher for objective observations. The researcher was a 'solo' researcher and he conducted the research solely by himself as there was no team participating in the research observation. There was a 'selective disclosure' whenever it was ethically needed to disclose the possibility of taking notes or inclusion of data in the research. The duration of the observation was for almost a year; thus was an 'ongoing over time' to have a general understanding of the entrepreneurship

ecosystem in Egypt and entrepreneurial finance. The focus of the observation was of 'evolving, emergent' on the micro-perspectives among the entrepreneurs' behaviour, and financiers' appetite and services; observing their behaviour, interaction, expectations, and preferences of the different groups. On a different level, a 'broad focus: holistic view' observation for the macro-perspectives part of the entrepreneurial finance and VC environment along entrepreneurship ecosystem in general. The observations included the regulatory and policy dynamics with policy makers, the developmental agencies objectives and support programmes, as well as other initiatives taking place in the entrepreneurship ecosystem.

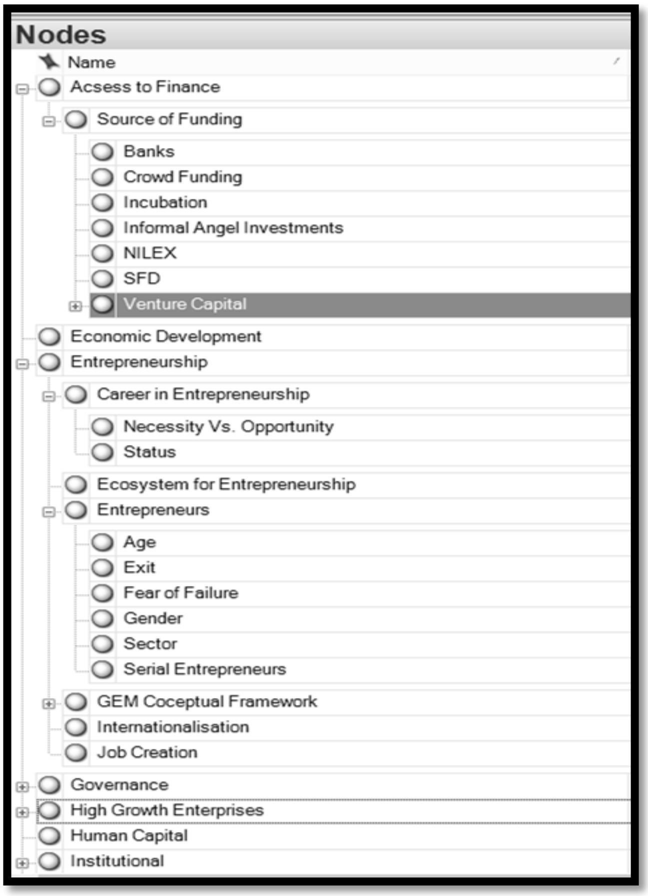
Regarding the role and exposure of the researcher as a participative observant of the research undertaken, the researcher was head of a small enterprises unit in a leading business association for almost a year with access to many entrepreneurs and small business owners and assisting with their financial and non-financial needs. Also, he was involved in a national business incubation project with the ministry of youth. Moreover, the researcher organised and chaired a high profile conference titled "The Existing and Innovative Financial Mechanisms for SMEs in Egypt" with panel discussion on all available and innovative financial tools and policy recommendations. The conference consisted of 3 panels other than the opening panel. The first panel was for the banking sector and leasing companies. The second panel was on developmental agencies and financing companies with a developmental dimension. The third panel was on innovative and alternative sources of financing, including venture capital, business accelerators, and crowd funding. On the opening panel was the Minister of Investment, the head of the Social Fund of Development (SFD) and the Islamic Bank of development. On another level, the researcher was on the advisory board of an SME financing company from idea inception and strategy formulation. The researcher was also closely linked to a VC firm that was established after Jan 25th 2011 revolution and had in-depth access to its investee companies. The responsibilities in this association gave contact to meetings with most of the development agencies in Egypt who have programmes in the domain of entrepreneurship and SMEs, such as, the USAid, the European Bank for Restructuring and Development (EBRD), and the Spanish Agency for International Development Cooperation (AECID). The unique exposure of this association gave the researcher the opportunity to recognize and interact with most of the stake holders in Egypt regarding entrepreneurship and entrepreneurial finance. In addition there were many roundtables and workshops with industry professionals in the same domain that added to the gathered data over the scope of the year.

The researcher was specifically observing the dynamics of the entrepreneurial ecosystem and the status of entrepreneurial finance, developmental agencies and financiers. The observations allowed capturing the perception of the stakeholders and expectations of each side of the table. Further observations of the dialogues between entrepreneurs and financiers pictured the power struggle beyond dialogues. All this enabled a larger understanding over an extensive period of time to stand on the current status and reflect on the findings and other secondary and primary data gathered via interviews.

5.7 Data Analysis

The research adopted an 'analytical framework' approach organised as 'issues', which in this case was organised on the macro and micro levels. On the macro level, topics such as institutional categories, normative, regulatory, and cognitive institutions are used to group the findings. On the micro level, activities and VC firms' behaviour are categorised mainly under, fundraising, investing, value- adding, and exiting. In assistance of standard analysis, QSR NVivo (a software programme commonly used in qualitative research) was used to code the data and analyse it. It is used to help find trends, patterns while also organising the coded data for easiness and efficiency of retrieving and recalling the needed information. According to Bazeley (2007), the five principles NVivo supports in analysing qualitative data are to manage data, manage ideas, query data, graphically model, and report from the data. Using a computer analysis also helps to add rigour and might help working more 'methodological', more 'thoroughly', and 'attentively' (Bazeley, 2007). The NVivo software was found of particular benefit in combining the primary data gathered and the secondary data under themes 'codes' and sub themes 'child nodes' which was found invaluable in the retrieval and analysis of the data. A screen shot illustrating how the nodes and child nodes looked during the course of the study with NVivo is illustrated in figure (5.1).

Figure (5.1): Nodes and Child Nodes in QSR NVivo



The research uses a manner consistent with a grounded theory approach; thus an 'inductive analysis' takes place through establishing themes, patterns or categories, from being 'grounded' and 'implanted' in the data where embedded meanings and relationships emerge (Patton, 2002). When the data patterns and categories are clear and meaningful a re-check via 'deductive analysis' takes place to make sure that the findings are consistent with the hypothesised theory (*op cit.*). In the case of this research, the part concerning deductive analysis was only to justify the findings along with the main research questions and existing knowledge and theories. However, the interest in grounded theory approach lies in its process and of its data gathering and rigorous analysis technique of continuous 'checking' and 're-checking' on the emerging topics.

5.8 Data Validation

Validity is an objective rather than a product; it is relative to the purpose of the research and through evidence rather than methods that a researcher meets this objective (Maxwell, 2005). Among the validity threats in qualitative research are researcher's 'bias' and 'reactivity' (Maxwell, 2005). It is not the primary concern of the qualitative researcher to eliminate bias and reactivity, yet it is important for the researcher to understand how he influences on participants' behaviour and interviewees (Maxwell, 2005). To ensure quality and credibility of data several measures were taken into consideration. Patton (2002) detailed the validity criteria as follows; objectivity of the enquirer, validity of the data, systematic rigour of fieldwork procedures, triangulation, reliability of codings and pattern analysis, correspondence of findings to reality, generalisability, strength of evidence supporting causal hypothesis, and contributions to theory.

‘Triangulation methods’ are argued to be a consistent tool for data validation, amongst other tools (Mason, 2002; Maxwell, 2005). Concerning data triangulation methods, quality of data, credibility, and validation are all essential in this research. Triangulation depends on several sources in solving a problem. In which difference in methods, data collection and analysis ensures data consistency and therefore validity. Patton (2002) identified four kinds of triangulation, methods triangulation, triangulation of resources, analyst triangulation, and theory/perspective triangulation. In this study, ‘methods triangulation’ and ‘triangulation of resources’ were used. First, the data enquiry methods were based on interviews, participative observation, and secondary data of indices, documents, and reports. Second was the data resources collected with interviews, VC executives were compared to industry professionals, consultants, and policy makers. As well as a comparison of the data collected from VC firms with the brochures and documents collected from them prior to the interviews. Also in the case of the entrepreneurs and VC backed set of interviews the same methodologies were used and data compared to both VC firms and policy makers to ensure quality and credibility.

Validity of interpretation is another perspective of data validation; how the researchers interpret the findings might affect the ‘validity’ of these findings. However, in this research there are no claims for ‘ultimate truth’ and all data were objectively analysed to the best of the researcher’s ability. *“Validity of interpretation in any form of qualitative research is contingent upon the ‘end product’ including a demonstration of how that interpretation was reached”* (Mason, 2002: p.191). Furthermore, a detailed and objective ‘demonstration’ of how the findings were reached was presented in the findings and analysis chapters six and seven.

5.9 Study Timeframe

The timeframe of the fieldwork was between the years of 2008 and 2013. The research started with interviewing entrepreneurial financiers in Egypt, followed by the policy makers, the demand side (entrepreneurs), and then the industry professionals and consultants. The information gathered covered both the first and second questions which are: What are the main institutional determinants shaping entrepreneurial finance in Egypt? And what is the prospect for the development of a venture capital industry in Egypt?

Worth to mention is timing of the data gathering which took place before and after the January revolution in 2011. The huge upheavals during that period had directly affected the economy of Egypt and consequently the domain of entrepreneurial finance. Moreover, it had both positive and negative effects on entrepreneurship in general which are further illustrated over chapters 6 and 7.

5.10 Data Accessibility

The nature of entrepreneurial finance and specifically the VC/PE industry is quite different from most of other industries. The lack of disclosure and opacity on investments makes it even more complicated to gain access to information. However, good referrals are almost proven to grant access to those companies. The researcher was born and has lived in Egypt for most of his life thus is familiar with the culture, norms and language. This facilitated gaining access, and thus networking was not an obstacle. Moreover, the researcher has over fifteen years of experience in the Egyptian business environment and has access to influential associations in the country which enhanced networking opportunities. The researcher has also been close to the industry’s network during the last five years. He has attended several conferences and seminars on VC in Egypt which gave him some influential contacts who served as good entry points to access information. Along with research experience, business experience and knowledge on the subject, the researcher was chosen as a head of small enterprises unit in a prominent business association. Such an access was highly valuable and even opened more doors to the researcher and gained further access with industry professionals and members of development agencies. Furthermore, the researcher gained access to an SME financing firm as a member of the advisory board.

5.11 Conclusion

This study is an exploratory study with a core focus to generate an understanding of the current situation of entrepreneurial finance and the VC industry and its environment in Egypt, as an integral part of the MENA region. It examines the status of entrepreneurial finance and the VC industry's growth while relating to developed VC markets. Moreover, the research seeks explanations for the growth pattern of the VC industry; what is inhibiting the industry's development and what can be done to enhance its growth pace. This study assesses the effect of the institutional forces on the development of entrepreneurial finance and the VC industry as well as on the investment decisions of the present venture capitalists in Egypt. The in-depth interviewing with the major stake holders of entrepreneurial finance and the VC industry in Egypt is believed to have created both the depth in knowledge concerning the industry and the breadth needed to comprehend the whole topic. A key intention of this study is to provide benefits to VC professionals, entrepreneurs, industry consultants, and policy makers; while adding to the literature on entrepreneurial finance, VC international expansion, entrepreneurship in developing countries, and last but not least the utilisation of institutional theory in industry analysis of emerging economies.

Chapter Six: Findings and Discussions on Entrepreneurial Finance in Egypt

6.1 Introduction

This chapter discusses the findings on entrepreneurial finance in Egypt. It is based on the primary data gathered by interviews and notes from observations as well as secondary data findings from GEM and other professional reports. The discussions will relate to existing literature on the same domains of entrepreneurship and entrepreneurial finance knowledge and international experiences. This chapter is divided into two main sections; first is an overview on the current entrepreneurial finance status in Egypt, and second is an institutional framework analysis affecting the development of entrepreneurial finance in Egypt. The first section will start with an analysis of the available sources of funding for SMEs in general and entrepreneurs in specific. Discussions are grouped into capital structure preferences of entrepreneurs in the scope of available debt tools, bootstrapping, governmental initiatives, and equity financing. The analysis will focus more on equity entrepreneurial financing tools rather than SMEs, therefore the debt financing will be illustrated while further in-depth analysis will be on Angel financing, crowd funding, and VCs. Debt finance options in the Egyptian market are SME banking, leasing, factoring, and the supporting activity of credit guarantee. The governmental initiatives promoting SMEs and entrepreneurial finance are mainly the Social Fund for Development (SFD), and BEDAYA fund. After, is the analysis on equity financing tools containing the Nile Stock Exchange (NILEX) catering SMEs, and alternative sources of funding such as business angles and crowd funding, while venture capital is separately explored in chapter seven. An institutional theory lens is used to examine the institutional 'pillars' supporting and impeding the growth of entrepreneurial finance.

6.2 Debt Finance in Egypt

From previous discussions on debt financing in Egypt (see section 3.8.1), it was apparent that debt finance in general and SME banking in specific was unaccommodating to SMEs. According to interviews with industry professionals, financial consultants, and a board member of the Egyptian Credit and Risk Association (ECRA), it was found that the banking sector is very strong and cash rich. The excess in bank deposits was 52% directed to loans and deposits and 48% towards treasury bills; which was affected by the current economic uncertainties after January 2011 uprising. The experts added that the banks have very low risk appetite and are currently reluctant from serving sectors such as tourism, ICT, services, real estate except for budget housing and commercial projects, education, and hospitals. They indicated that such sector reluctance is not helping the overall performance of the Egyptian economy.

"It sure harms the economy, some of these sectors for instance real estate is a major driver of the economy. They [the banks] can't continue supporting the government's budget deficit and ignore the private sector" (Industry Professional).

The banks are currently concentrating on big clients, mostly manufacturing companies, in areas such as cement, petrochemicals, and infrastructure. They even prefer governmental and private public partnership (PPP) even when they are less profitable with interest rates reaching 10.5% when they can lend individuals (retail) for over 18% on personal loans, credit cards, and car loans. Retail lending is considered one of the growing interests of the banking lending portfolio. The experts explained this conservative lending approach to the history of the banking sector in

1990s. Board member of ECRA indicated that non-performing loans (NPL) reached at some point 180% of the total capital of some banks, mostly because they over lent the real estate sector. He added that they currently don't need to venture in risky projects, they have a high bargaining power, have very high profits, and most of them won't venture into SMEs. This was apparent for SME banking in Egypt, although it started to pick up in years 2004 and 2005 as a national strategy direction; only half of the 39 banks in Egypt are currently involved in SME banking (Poldermans, 2011). And even though the CBE passed a regulation in December 2008 reducing the reserve requirements for SME lending in an effort to provide a financial incentive to the banks (Poldermans, 2011), still there is no significant contribution by the banks towards SME financing. Elaborating on the CBE incentives ECRA board member viewed it relatively positive. He pointed that this incentive triggered the SME banking sector and indeed had a positive impact on the market.

"When the 14% required deposit is cancelled, it will decrease the cost of lending to SMEs by approximately 1.4%. This is quite significant considering the average net spreading income of banks [in Egypt] is of a 3.2%".

Through two different meetings with two of the SME heads of leading banks in Egypt, the researcher was requested to promote their services to SMEs in the association. They both indicated that they have unutilised SME dedicated funds, they insisted that it's very hard to find 'suitable' deals.

Regarding the major impediments facing SME banking, it was found that banks deal with SMEs the same way they deal with large corporations. Industry professionals suggested that an approach similar, yet more advance, to personal lending should be implemented. An industry professional pointed that the international experiences in SME banking have multiple automated screening methods that enables quick and efficient decisions. In the case of Egypt, it's a very lengthy procedure that would take at best 1.5 months for acceptance. Moreover, with such high rejection rates over 90%, it will be very consuming to deal with all cases on a similar level as larger corporations.

"To fully serve SMEs you must increase human capacity under the current situation. It's very difficult to do it this way and also very costly... I think it's even impossible to deal with start-ups this way. I believe I-Score can help with this problem when properly operational".

Other initiatives to enhance credit to SMEs such as the Credit Guarantee Company (CGC) took place; however in 2009 the company guaranteed just 45 transactions (Rocha *et. al*, 2011). Moreover, the company had just started its SME programme in 2011 (CGC, 2013), and hence the data on SME guaranteed transactions is not yet sufficient. In addition, credit rating is a necessity for any economy to enhance and facilitate its access to finance, especially SMEs (OECD, 2010b). In this respect, I-Score was established as a credit rating company and started operations in 2007. All these initiatives in addition of the introduction of leasing and factoring are believed to enhance the debt financing for SMEs. However, to date most of the experts believes that banks and regulatory bodies need further improvement and further flexibility with SMEs. Industry professionals suggest that banks should not approach SMEs the same way they approach large corporations and they need to ease the restrictions. Any registered company needs to have a minimum of 2 financial years to submit for a loan. They must have enough physical collateral to cover and this would exclude the vast majority of service oriented businesses. The experts interviewed indicated that SMEs are not helping the banks to serve them properly. It was found that some financial statements are not indicative of their real trading and are used to decrease their taxes. In such cases banks could not accept any other form of financial statements and won't lend the business. Other problems were found that some SMEs lack professional accountants and a reliable accounting system. In addition, many SMES are incapable of preparing a realistic business projection to their business plans. The problem with SME banking and access to debt finance is thoroughly discussed in literature (sections 2.3 and 2.6). It is an inherited trait regarding the size and age of the ventures, caused by information opacity, weak cash flows, and lack of collaterals (Berger and Udell, 1998). However, in the case of Egypt, the case might be more stringent regarding sector reluctance and the low appetite of risk for private sector lending in general; and lack of banking 'capabilities' in setting realistic selection criteria and weak supporting credit guarantee and credit rating for SMEs in particular.

From a demand side perspective, most of the interviewed entrepreneurs showed apprehension regarding banking finance. It is important to stress that the statistical benefit of interviews is not the objective of this study due to the small sample as well as the variance upon age, size, type, and personal preference of the businesses among other variables. The value of this study remains to answer the why questions; hence the qualitative nature of the study. The objective in this section is to explore why entrepreneurs would prefer one type of finance over another. The first sample which was five entrepreneurs, three out of five showed little or no interest to approach banks and preferred equity in the form of partnerships. A further sample of ten entrepreneurs was interviewed for further understanding on the same topic. Eight out of ten, totalling eleven out of fifteen (both samples combined), considered banking finance to be their least preference to finance their business. Out of those eleven, three chose religious grounds and fear of legal consequences in case of distress and the other eight showed only fear of legal consequences and no religious motivation. The types of business of those entrepreneurs were deliberately chosen to be bankable businesses, in other words, from the retail and manufacturing businesses that are most likely to possess tangible assets and collaterals.

The overall findings, suggests that the negative outlook towards bank finance might partly be counted for an important regulatory (fear of legal consequences) as well as normative (fear of a negative societal perception) and cognitive (religious preference) determinants, which might partly assist the rationalization behind small numbers of SMEs applying for banking facilities. There was also a conception that banking regulations are 'too complicated'. It was apparent in most interviews that entrepreneurs feared the legal and societal consequences of bank faulting more than cognitive and religious reasons.

An entrepreneur mentioned:

"Despite the so many difficulties of partnership, partners usually cooperate together for good and for worse... yet banks have no mercy and if the investor is unable to return the loan with the interest he is completely ruined".

First, banks usually ask for multiple personal guarantees in the form of cheques and other abiding commercial papers that are capable of imprisonment without going through commercial courts. Second, the stereotype on not being able to repay the debt is highly degraded by the society.

“In the back of their mind is this stereotype. Nobody differentiates whether the businessman is distressed or a thief. Everyone will call him a thief and he might end up in prison” (Industry professional).

Indeed, the negative media effect on businessmen and bank loans were highly topical in the early 2000s, famous cases of businessmen imprisonments were highly exposed and scrutinised in all means of media, mentioned an industry professional. A different point of view was presented by a different entrepreneur regarding his preference for bank loans versus partnerships as a mean of growth, his preference to debt was clearly evident

"of course dealing with banks is much easier than having a partner as long as the project is thoroughly studied and the profit margin is reasonable, partners usually have different opinions and work priorities… on the contrary the bank is a silent partner who invests the money and reaps the profit at the end without interfering".

Yet, the conceivable preference of equity financing by entrepreneurs over debt financing, specifically bank lending, prevailed to be more observed. This was well summed in the following quotation by a VC/PE director:

“the norm in Egypt is not to get a loan from the bank, it’s part because of Shari’a and the other part fear and unfamiliarity with banks... it’s a mix... some don’t care for Shari’a compliance, they would care more on that banks can ‘sell your clothes’ <<can leave you with nothing>>...”.

Those initial observations could be supported by the SMEs access to finance report by El-Said (2010) indicating that 92% of the interviewed SMEs would prefer a venture capital over debt type of financing and over 50% of the SMEs sample did not apply for loans whether short or medium-long term facilities in 5 years. In addition, a study by El Kabbani and Kalhoefer (2011), using questionnaires for 190 SMEs in Egypt, found out that over 32% responded with yes for considering VC as a mean of finance and over 51% with maybe while only 8% answered no or don't know. However, their findings were more evident in smaller firms than larger ones.

From a cultural-cognitive perspective, interestingly none of the industry professionals' interviewees mentioned anything on banking and *Shari'a* or Islamic finance preference of SMEs. However when they were asked on what they think of the effect of *Shari'a* compliance on banking, they all agreed that it is important to some business owners and not all of them. One of the financial consultants indicated that approximately 20 to 25% of his clients would only use Islamic banking and the 75% had no preference whether Islamic or commercial.

Regarding non-banking debt tools, industry professionals saw a growing opportunity for SMEs with leasing and factoring. It was found that factoring is currently not covering SMEs in Egypt, with one company operating and serving businesses with an annual turnover of 40 million (EGP) (approx. 3.6 million GBP). According to the Egyptian leasing association, there are currently 10 major market players in the financial leasing market accounting for more than 90% of the new contracts (ELA, 2013). A financial consultant indicated that the market in Egypt only works with financial leasing and not operating leasing. The difference is that with financial leasing the customer has to pay for the whole financing and then own the asset at the end of the contract while operating has a main objective of renting and using it and hence not paying the full amount of financing the asset. Furthermore, it was found that leasing companies are capable of an 8 times leverage and are mostly partnered with major banks, this affects the industry resulting in higher costs for financing and higher influence of the banks. This also leads to the same restrictions and requirements applied by the banks in regard of SMEs.

"The banks are highly involved in the [leasing] sector; the vast majority are backed by banks. You won't be surprised if they ask for the same banking requirements... It [leasing sector] is improving and it is still in its early stages" (Industry Professional).

The leasing sector is growing and it reached 6 billion (EGP) in 2012 (approx. 550 million GBP), with 3500 transactions the average transaction is around 2 million EGP, therefore it can well fit within the context of SMEs, however the size and volume of the Leasing market is still below expectations yet improving, according to industry professionals.

From a demand perspective, an entrepreneur indicated that leasing was one of the best financial tools for his business. The value increase of the asset, especially with high inflation rates and currency fluctuation, was found an extra benefit for his lease decisions on the long run. Another entrepreneur complained about the excessive guarantees required by leasing companies. He mentioned that the leasing company asked for suppliers' personal guarantee, in addition to two board members' personal guarantee, on top of collateral guarantee of the machinery he was buying. He argued that personal guarantees in the form of personal promissory notes are inadequate for such business deals particularly when the leasing company gets the machinery as collateral. However, he appreciated the Islamic compliance of the leasing industry and believed it suits well his business type and his personal preference.

6.3 Bootstrapping in Egypt

Kabbani and Kalhoefer (2011) found that the majority of SMEs would internally finance their businesses. From findings from interviews with industry professionals and entrepreneurs, bootstrapping was a significant source of financing to the vast majority of entrepreneurs in Egypt. The sample of entrepreneurs showed that all entrepreneurs used one way of bootstrapping at some point in their businesses. A common method for small amounts of capital was personal loans and personal credit cards. This might suggest that smaller personal loans were more acceptable than larger business loans. Although the primary reluctance to bank financing was fear of legal consequences, small personal loans were found less risky for entrepreneurs. Deferred payment was another common method whenever it was possible. In small ventures, deferred payment was mostly found in regard to office equipment, computers, and air-conditioning equipment. In addition, regarding manufacturing firms and trading companies, deferred payment was mostly to suppliers of machines, goods, and raw material. Although this was not novel to the Egyptian market, what was noticeable is the tool used regarding such payment deferral. The case was usually paying a down-payment and the rest of the amount by deferred cheques or promissory note. According to an industry professional, deferred cheques were most commonly used among manufacturing companies, specifically for purchasing raw materials, and retail outlets for buying merchandise. Further investigation on this concept from a legal perspective took place. An interview with an industry professional with an elaborate legal background took place. It was found that there was no legal description for a deferred cheque, and all cheques were due on the date of issuance. However, traders do write cheques with future dates and the cheques were ‘closed’ to be only withdrawn from the beneficiaries’ account (not over the counter) and thus could only be admitted on the date written on the cheque. It is believed by many industry professionals that, unlike many countries, this tool is very common in Egypt. Moreover, according to the legal consultant, the strength and credibility of the cheque lies in the fact that a rejected cheque is a petty crime punished by imprisonment for up to three years and/or a fine of up to 50,000 Egyptian pounds (approx. 4,000 GBP). Unlike other commercial paper, such as promissory notes which would in worst cases lead to bankruptcy, a cheque is a well established tool for credit in the Egyptian market. Thus regarding the main methods of bootstrapping by Winborg and Landstrom (2001) (see section 2.7), the most commonly used methods in Egypt would be personal loans and credit cards, in addition to delaying payments to suppliers. The use of deferred cheques might be a method particular to the Egyptian case.

6.4 Governmental Initiatives

Two governmental initiatives regarding SMEs and entrepreneurial finance took place over the past two decades, the Social Fund for Development (SFD) as a debt financing tool (section 3.8.2), and on the equity finance side was Bedaya Fund established by the Ministry of Investment (introduced in section 3.8.3.2).

Regarding the SFD, an SFD official indicated that a joint programme between SFD and the World Bank is underway. This initiative is to establish a VC pilot fund which will be replicated with larger amounts if found successful. The SFD chairperson also highlighted the role of the SFD in future equity financing programmes. She believed the SFD should have a significant contribution to equity financing as it currently had in MSME lending. With an interview with a policy maker, he suggested that the SFD can play a major role in entrepreneurial finance and can initiate joint programmes in a government-private partnership. On the other hand, industry professionals were sceptic about the role of the SFD. An industry professional indicated that there are too many red tapes with dealing with the SFD. He added that they give very little technical support to their borrowers. An industry professional stated:

"Some government initiatives like the SFD are dedicated to SMEs... it is not very clear how?... SFD say they finance up to 2 million pounds [EGP], but we never saw that...never heard of it... specially that the SFD finance through banks and this allowed banks to apply their own criteria...".

The SFD uses some of its credit lines to be lent by banks to SMEs. This was also observed in the field work. Two of the banks that were offering their SME finance services to the association had an SFD programme of lending within their SMEs financial products. An industry professional argued that this approach was not to the benefit of SMEs, for the SFD should have more lenient criteria regarding SME lending than commercial banks. Moreover, he argued that it would increase the cost of lending to SMEs with further intermediaries. Most of the industry professional believed that the SFD is hiring new high calibres and would expect its services to improve as it is already noticeable. In addition, the capacity and reach-ability of the SFD in most of the Egyptian governorates would entitle it to play the largest role by the government towards enhancing SME and entrepreneurial finance.

The second government initiative was found to be Bedaya fund. Industry professionals interviewed were not clear about the strategy and mandate of the BEDAYA fund. This could be the result of the newness of the fund and the lack of known deals at the time of the interviews. The fund, however, was actively seeking deals through the Ministry of Investment and the fund management company. According to an industry professional:

"Bedaya fund is not obvious whether they finance start-ups or not... but knowing them they are not very interested to finance new ventures... they want a venture that is trading for 2 to 3 years and is successful and in the growth stage and then they can finance in this case <<in a sceptic tone>>…".

A further interview with a senior advisor at the Minister of Investment indicated that they needed to promote this fund. He mentioned that this fund was meant to be much larger and could have acted as a fund of funds. He added that banks were encouraged to invest in the fund and were expected to have larger contribution in the future. Moreover, the fund managers found it challenging to select deals that would match the fund's criteria. The role of this fund in entrepreneurial finance domain in Egypt is still early to assess, yet the initiative of an equity fund remains of substance to the entrepreneurial environment in Egypt.

6.5 Equity Finance

External equity finance is through public markets, private investors, formal and informal venture capital. Regarding public markets, it was found that the NILEX stock exchange for SMEs offering equity finance in Egypt was still in a very early stage. There are currently 23 listed companies of which 22 are trading. Two were listed in 2008, three in 2009, a record high nine in 2010, three in 2011, three in 2012, and four in 2013 of which one is not traded yet. The current numbers and volume are not what was expected from the launch of the NILEX, however the obvious effect of the political situation visible in 2011 through 2013 maybe a good explanation specially with the record high of 2010. On another level, only two companies out of the 24 listed companies are in the technology business.

The interviewed industry professionals viewed the NILEX as a potential exit mechanism that is not yet fulfilled, rather than a growth equity source. A PE/VC director argued that the NILEX is at a complete halt and for the time being did not prove reliable as an exit option.

An industry professional had this opinion on the NILEX:

"The NILEX up till now is in the pilot phase... as a pilot project it is successful... as a stock market and a mean to finance SMEs it is definitely not... it would be a failure project... we have twenty something company with an average of 5 million paid in capital... this is not bad... there are smaller and larger but this is the majority... the other point is the subscription regulations... there must be profitable balance sheets... with a profit of 5% minimum for the last year as a percent of the capital... this means we can't accommodate start-ups...".

He further added that the regulations for the NILEX are changing as they they're currently un-inviting for the brokers and investors alike. This causes the NILEX to have a very small volume of trading and this needs further encouragement. Moreover, he argued that the NILEX should also change the regulations to be more accommodating to entrepreneurial ventures and start-ups. The remaining, more significant, external equity financial tools were found to be through partnerships, family and friends, or angel investors. In addition, the tool of crowdfunding as a newly introduced concept to the Egyptian market was further explored. Finally, the option of venture capital is discussed in more details.

6.5.1 Informal Finance and Angel Investment

6.5.1.1 Love Money

"Love money" is when investors expect no return at all, mostly invested in family member's businesses; it was estimated to be approximately 2.8 billion EGP (250 million GBP) (Hattab, 2008). Similar findings to the existence of large sums of love money were found all over the MENA region reaching approximately 25% of informal angel investors (Stevenson *et al.,* 2010). According to an industry professional:

"Entrepreneurs, like any other start-up company, face very big problems to access finance... Especially the conventional ways, the biggest part is the banks... they [the banks] don't see them. Especially when the ventures have no tangible assets, like IT and technology related or services... they won't be able to access anything from these regular channels... They would be left with social, friends and family finance... those are the only ones that would help them start their business".

Family ties and social networks are highly appreciated in the Egyptian society as well as MENA region, it stems from both a cultural and religious motivations that are in favour of strengthening those ties. Through interviews with entrepreneurs, the majority indicated that they have used family finance whether on a debt or equity basis at some point in their business. Friends finance came in as a second choice. Family financing is a well established source of funding for entrepreneurs all over the world, and in the case of Egypt it was no exception. However, the majority of entrepreneurs showed that family financial support with no return is 'natural'. Furthermore, some indicated that it was 'normal and expected' for their families to support them whenever in need and the family's financial conditions permitted. The family members who were expected to support entrepreneurs were even extended to uncles, aunts, and cousins. It was expected from the 'well off' family members to support other members. This was found true on all levels of support; whether on a charitable basis or on a business agreement and venture financing basis. Family ties in Egypt were very strong, however it is argued to be weakened over the past 30 to 40 years due to 'rapid social mobility' among Egyptian social classes (Amin, 2000: p.25). Amin (2000: p.9), argues that economic liberalization caused by the 'Open-Door' policies in the 1970s are *"the most common explanation for these various manifestations of economic, social, political, and intellectual malaise"* which by its role had affected the social structure of the Egyptian society and accordingly weakened family ties.

As examples for 'love money', an entrepreneur indicated that the seed capital for his start-up business was a loan from his father with 30% profit share for a period of three years right after his graduation. On the other hand, another entrepreneur stated that his father would lend him on a short term basis and the entrepreneur found the notion of a return on this money absurd. The aspect of 'love money' was noticeable in Egypt and the MENA region; it was also evident along many developing countries in GEM reports, what could be distinctive in the case of Egypt was the 'taken for granted' attitude for family support noticeable in entrepreneurs' interviews.

6.5.1.2 Partnership and Cooperative Finance

According to industry professionals, the business culture in Egypt was found to have a very high emphasis on partnership. There is a high respect and appreciation for partnerships. However, it remains difficult to gain trust that would lead to form a partnership. It was commonly resembled to marriage as a long term commitment by many entrepreneurs. Most partnerships took place among family members, extended family, friends and colleagues. All the same, adversity, problems, and control struggle were among the common negativities established over partnerships. For many businesses the purpose of partnership was found to be primarily as a mean of finance. It might as well be the most common way to finance a start-up business in Egypt. Whether there is any value added, apart from finance, by joining the venture is questionable. An industry professional emphasised how partnerships are common as a means of finance:

"People are different... some don't like banks... they want a partner... I noticed they don't like institutions... they want someone to invest and have no say... this itself kills the purpose... their success rate is low..... They just don't someone to supervise them and force contracts on them and interfere with their decision...".

Passive cash partners and control struggle was an important factor in many of the interviews with entrepreneurs. In an entrepreneur interview, for him a partnership needs to be regulated and controlled in the form of a joint-stock company otherwise it would lead to financial problems. It should have no concern over friendships, he added, thus if one partner ceases to invest in the project, his share can be reduced while the share of the other partners increases accordingly by raising extra capital and hence the business will continue. He continued to argue that partners should be sought for their expertise or effort; when it's for the sole purpose of money, banks could be a better alternative. He added that the partner could be beneficial if he is a businessman with excess money to invest, and seeking a reliable trustworthy partner while he himself remains a silent partner. The whole idea is that partners should not interfere in each other's job which is quite difficult to accomplish, he mentioned:

"It will never work when all partners are trying to steer the wheel!".

The whole concept on partnerships as a mean of finance was highly visible; however, the control struggle and the optimum profile of the cash partners were the key concern of entrepreneurs. Thus partnerships taking place in Egypt might take place for the sole reason of finance. With very little alternatives and apprehension over bank lending, partnerships are heavily used as a cooperative form of equity financing. It might be argued that non-value-adding partnerships lead entrepreneurs to give away valuable equity stakes for the lack of alternatives in the form of debt finance.

According to entrepreneurs and observations, cooperative financing took place among traders who partner in groups to import goods, in case a single trader can't afford to purchase a full vessel container of merchandise. In the course of entrepreneurs interviews, a different cooperative financing method was further observed called '*Gami'a*' translated to 'association', where a group of traders (mostly 12 members to fit a calendar year) or business owners paid monthly, weekly, or even daily amounts of money and a member of the group received the whole sum on a rotational basis according to their needs. Each trader could subscribe with a full month or more, or share half a month with another trader. Although, this concept is well established in Egyptian households, more evidently in the lower income segments, little was known on its applicability in businesses in Egypt. In particular, this concept was more noticeable among traditional businesses and small traders; nevertheless, the amounts varied significantly from very small amounts to up to

100,000 EGP (approx. 9,000 GBP) monthly where a trader can benefit from a larger sum of 1,100,000 EGP (approx. 100,000 GBP) over a calendar year. It was further explained that the least in need among the group would tend to collect the sum further to the end of the *'Gami'a'*, while those in high need for the money collects them first and those are most probably the initiators of the *'Gami'a'*. Moreover, after reviewing academic literature on the topic, similar observations were found in other developing countries under the concept of 'Rotational saving and credit associations' (ROSCAS) in Africa, Asia, and New Guinea (Callier, 1990). Several researchers explored this concept; such as in the case of rural East Africa by (Kimuyu, 1999), in Cameroon by (Tankou and Adams, 1995), and in Nepal by (Chhetri, 1995). The role of informal financing in developing countries in the form of group lending and ROSCAS were believed to be highly significant within countries of weak formal financial institutions (Christensen, 1993; Ghatak, 1995; Anderson, Baland, and Moene, 2009). The role of trust and networks are among the determinants of this method of rotational saving and lending.

6.5.1.3 Business Angels

Until recently, there were no professional Angel financiers as known in other developed markets. From observations of the researcher in the field work, it was found that some of the well known Egyptian business persons tend to play a similar role. However, it was found that some angels were motivated by charitable and cooperative acts for entrepreneurs in need of finance. Other angels were found to support complementing businesses to their core activities through other entrepreneurial ventures. Yet they might not be the habitual conventional business angel type, and they don't even position themselves as such.

According to a PE/VC director:

"Business angels are not so many... they don't even see themselves as such... they are mostly successful businessmen who sees a good opportunity of any kind and decides to go for it... it is never a planned activity, it is not intended to be a business angel activity... the composition of entrepreneurial finance in Egypt is highly unstructured".

Although, angel financing was evident in Egypt (Hattab, 2008); however, an organised initiative was non-existent until the formation of 'Cairo Angels'. After the January revolution and the increasing entrepreneurial activity, a group of young businessmen tried to organise their efforts of angel investments. They formed Cairo Angels (CA) *"Egypt's first formal network for business angels"* in early 2012 according to their website (Cairo Angels, 2013). "*The idea for The Cairo Angels was in mid 2011 and we hosted our first angel pitch session in February 2012, angels to invest in interesting and high potential start ups and enjoy the satisfaction of guiding entrepreneurs and participating at [a non-] executive level. We started with about 10 [angels], today we have 50 registered [members], within 18 months I'm hoping to have 100 active angels at which point it will probably not be effective to have any more. Instead I hope other angel groups will emerge."* (Founder of CA: Aysha, 2012). Each member of the network makes his own investment decision, yet they collectively work on the due diligence of their investees. The size of investment ranges from 250,000 EGP (approx. 20,000 GBP) to one million EGP (approx. 90,000 GBP). Their investment strategy is to get a minority stake and hands-off approach and expect a multiple of 3 to 5 times in 3 to 5 years, assuming that a multiple of 10 for the same period is achievable in Egypt.

"Conventional wisdom says that an angel should always seek some level of [non]executive participation but we are relaxing this requirement until deal flow is more steady. In the meantime we have some angels who simply want the capital exposure while others want to be involved in grooming the entrepreneur before an investment has even been made!" (Aysha, 2012). They position themselves as generalists yet the majority of their investments are in technology businesses. They advertise that they wish to invest in the agricultural, logistics and energy sectors, and hope to see more women entrepreneurs applying (Cairo Angels, 2013). Syndication is within their scope whether internally in their network or with other early stage financiers. They meet once every quarter and receive around 4 to 5 pitches via their main deal sourcing partners who are mainly Egypt's incubators, accelerators and universities, and from direct approaches and often from more mature entrepreneurs. The geographic focus is mainly in Cairo; however they do welcome regional entrepreneurs and have been approached by pitches from Jordan, Lebanon, and Yemen. It is noticeable that Cairo Angels invested in six ventures in less than two years, of which four executed deals and further two with committed capital. The first four collectively amounted to 1.1 million EGP (approx 100,000 GBP) which is an average of their minimum investment requirement, yet the later two ventures amounts to one million EGP which shows an increasing appetite for risk. An example of their investments is *Iqra'ali* (meaning: Read for Me), which is a mobile app that reads selected magazine and news papers articles, mostly dedicated to long hours drivers in Cairo traffic. It is an example of using technology to overcome a specific local problem. An entrepreneur who is angel funded argued that it took him over 12 months to raise funds for his venture. He added that 41% of entrepreneurs, according to a MENA region survey, found access to finance as the major hurdle towards

entrepreneurship in the region. The culture of angel investments is missing in Egypt, he added, and even family and friends are not encouraged via tax bracket exemptions such as in the United States for instance. He continued to argue that raising a second round is even harder if possible at all.

"Our case is the exception... this is not the general rule [to access funds]... We are very very lucky to do so, many entrepreneurs whom I'd consider much better than us couldn't raise any!".

6.5.2 Crowd Funding

Crowd funding is one of the latest entrepreneurial finance vehicles worldwide. 'Shekra' is a crowd funding platform that was established in Egypt in November 2011 after the January revolution (Wyne, 2013). The word 'Shekra' stems from the two Arabic words *'sharek'* and *'fekra'* meaning 'share' and 'idea'. Shekra's management team are a group of four. They all share high level of international education and experiences from the United States, Germany, and the UK. The idea is that Shekra prepare new ideas and assist them with their business plans until they manage to raise the required funds through Shekra's platform. In return, Shekra acquires a small equity in the new venture, in addition to a minimum fee charged for services such as business plan support, due diligence, and monitoring (Shekra, 2013). The business proposal of Shekra is *"Conventional funding sources such as family and/or friends, venture capital funds or banks are often not the right choice due to a number of drawbacks such as limited funding being "too small" for the big investors or not willing to take funding based on interest due to the burden or religious considerations. Shekra solves this problem by supporting entrepreneurs to fund their* *start-ups through its crowd funding platform relying on a network of validated and reliable investors"* (Shekra, 2013).

According to one of the founding partners of Shekra, they target youth and student entrepreneurs aiming to increase the success rate of start-ups. He added that Shekra values itself for being Shari'a compliant, socially responsible, and sustainable. Until June 2012 the platform managed to raise funds for three venture out of 150 applicants with an average of 150,000 EGP each (approx. 14,000 GBP) (Wyne, 2013).

Founding partner pointed that the idea came from the high entrepreneurial activity in the region and its positive economic impact. He mentioned:

"*15% of young Arabs wish to start their own business which has a high economic impact... SMEs in Egypt contribute to 38% of the employment and 38% of the GDP."*

He further illustrated the major obstacles facing entrepreneurship and entrepreneurial finance and stated that the regulatory dimension is

"*typical... lack of policies simplifying and speeding the processes"*.

Regarding entrepreneurial finance he argued:

"There is a need for entrepreneurial ecosystem, and most importantly funding, the missing middle and lack of profit and loss sharing equity in SME financing. It's usually too big for micro-finance and too small for private equity funds and too risky for banks".

The three levels of involvement of Shekra with entrepreneurs, according to their founding partner, are grouped to pre-funding, funding, and post-funding. The prefunding phase includes, viability, business education, due diligence, valuation, and business planning. The funding stage includes pitching and fund fulfilment. And the final stage of post funding includes, legal structuring, mentoring, and monitoring. He added that their deal sourcing primarily depends on their own outreach, NGOs, incubators, and competitions. He mentioned that their investors are from all sizes, they can be locals, expats, institutions, business associations, or from GCC countries.

Industry professionals suggested that crowd funding could be successful in Egypt. According to an industry professional:

"Crowd funding is a good idea… although abroad [in developed countries] the sweet spot of CF is 20000 USD... this model can be applied in Egypt but with larger amounts... and there would be a hub that receives the money for certain ventures... people are willing... if anyone had an idea with a good return people are in it... the number of people who seeks a return on their money are higher than those who seeks investments..."

Worth to mention is that there are no laws or regulations governing crowd funding in Egypt. A platform could be managed from Dubai, legally setup in South Africa, and invests in Egypt. The nature of crowd funding as an electronic platform doesn't restrict the physical existence to its legal setup. The same case applies to all crowd funding platforms in the MENA region. According to Ideation Centre (a think tank of Booz & Co. in the Middle East), *"Middle Eastern players seem to be working slowly but surely on importing this model [crowdfunding] into the region. These players, such as eureeca.com for equity investing, zoomaal.com and aflamnah.com for* *creative projects – just to name a few, seem to have found their way around the lack of regional regulatory frameworks that support or govern various Crowd funding models. Other players have alternatively decided to only have a local presence, but offshored the payment side of their operation outside the Middle East to eventually avoid having to face off with any eventual regulations that could emerge and have a direct impact on their business model."* (Khalil, 2013).

6.6 Summary

From previous discussions, it is apparent that there are many concerns regarding banks' support to SMEs and start-ups. From the supply side, SME bank finance was a humble 5% (Rocha *et al.*, 2011) with less than half of SMEs dealing with banks (El-Said *et al.*, 2013). Moreover, banks were argued to be risk averse towards SME banking, especially with the availability of alternative profitable opportunities. On the demand side, not surprisingly SME firms' imbedded difficulties in the form of scale, lack of collaterals and opacity were among the hurdles to match banking requirements. Furthermore, fear of legal consequences, negative social image, and religious preferences were among the reasons why entrepreneurs might be apprehensive towards banking finance. Further debt tools were also present; however the leasing industry was found the most significant and growing tool. It was positively perceived by industry professionals and entrepreneurs alike. *Shari'a* compliance was among the positive factors making leasing a favourable option. On the other hand, the high involvement of the banking sector in the industry was argued as to be a negative aspect due to the perceived stringency in banking selection criteria by industry professionals.

Further financing options were explored, and bootstrapping was found to be an important common practice among entrepreneurs in Egypt. Besides personal loans and credit cards, deferred cheques were common in delaying payments and gaining credit from suppliers. It was argued by industry professional that the extent and significance of deferred cheques in Egypt is a distinctive feature of the Egyptian market.

Governmental initiatives were found to be the SFD and Bedaya fund. The SFD was mostly involved with micro enterprises and was criticised for red tapes, low level of technical support, inclined towards micro loans, and once more high bank involvement. The SFD was strategically getting involved with equity finance while developing its human resources. On the equity side, Bedaya fund and the NILEX were found to be in an early stage with little impact on the entrepreneurial finance arena in Egypt.

To compensate for the insufficient formal sources of finance, the informal financing and love money were found significant. In respect of 'love money' there was a 'taken for granted' attitude for financial family support that would extend beyond direct family members. Entrepreneurs were found as likely to pay return on money borrowed from their family as not paying any return at all. Among other forms of informal financing was partnership as a source of finance and not for any other value adding activity. Other forms were evident, such as the rotational saving and lending *'Gami'a'* model. It was a well-established household activity that was applied mostly among small businesses signalling a cooperative approach based on trust and close social networks.

The business angel concept was found to be different from the habitual model. However, a group of angels recently formed a consortium of angels that was found similar to the western model found in Europe and Anglo-Saxon economies. Furthermore, crowdfunding was also present in Egypt reflecting a globalisation effect and high pace of knowledge transfer.

However, it remains that potential high growth enterprises (HGE) are facing more challenges over and above the challenges facing start-ups and entrepreneurial ventures in general. Indeed, it has been argued that HGEs are the most significant to a country's economic development and the highest contributor to job creation; sufficient funding among other factors is vital for their growth (OECD, 2013). Therefore this thesis deliberately focuses on the role of VCs in Egypt and their capability to support the growth of HGEs. Hence, the VC industry in Egypt is separately explored in chapter seven in thorough details.

6.7 Institutional Determinants of Entrepreneurial Finance in Egypt

Using an institutional theory lens and the three categorisations: regulatory, cognitive, and normative (Scott, 1995) as a conceptual framework, are utilised in the analysis part. It is worth mentioning that some of the normative and cognitive determinants are intertwined and over lap at some points. And thus the illustration of this analysis was made indicative for analysis purposes and not to find a categorisation of institutional determinants regarding entrepreneurial finance. This section builds on previous discussions, after the overview on the environment of entrepreneurial finance in Egypt, and answers the first of question of this research: What are the institutional determinants shaping entrepreneurial finance in Egypt?

6.7.1 Normative Forces on Entrepreneurial Finance in Egypt

The normative perspectives are the social values and social norms affecting the behaviour of an individual, organisation, or society (Scott, 1995). It implies what is socially appropriate and thus abiding to the societal expectations. The basis of compliance to this pillar is through 'social obligation' and thus it is 'morally governed' by the society. It is noticeable that the majority of the normative determinants were regarding entrepreneurship in general. However, the effect of the demand side (entrepreneurs) on entrepreneurial finance was found of importance in the course of primary data gathering.

6.7.1.1 Education

The importance of education on shaping entrepreneurship was signalled by the majority of interviewees; it emerged to be an important determinant concerning the demand side of entrepreneurial finance. A crowd funding director stated:

"there is a shortage in high quality formal and informal education, students don't think entrepreneurship".

This was also evident in other interviews with entrepreneurial financiers. A PE/VC director argued that there is a lack of proper education that qualifies the major supporting activities such as accountants, financial managers, and legal personnel. The role of education on entrepreneurship and the need for entrepreneurship education are evident in the literature (Peterman and Kennedy, 2003; Kirby, 2004). In OECD report (2013) regarding HGEs in the MENA region, it signalled an urgency to introduce curricula on education and training for entrepreneurship to all educational level. GEM reports addressed education as an essential factor to entrepreneurship in different economies; the national experts in Egypt believed that Education is the most important constraining factor towards entrepreneurship. It is believed that the Egyptian educational system on all levels is relatively poor and insufficient, which is reflected in the overall rank falling last on education and training in 2008 and 2010 (Hattab, 2008; 2011). In the MENA region it was found that less than 5% received any form of education on how to stat their business in formal education (Stevenson *et al.*, 2010).

6.7.1.2 The Role and Influence of Associations

Another normative determinant would be the associations currently involved in promoting entrepreneurship and entrepreneurial finance activities in Egypt. It was found that there were limited initiatives regarding associations for business incubations and venture capital activities. There exists an Egyptian Incubator Association (EIA) which was established in 1995 after the incubation concept had been initiated in Egypt in 1992-1993 through a UNDP initiative, yet its efforts were directed to support the SFD incubators (ESCWA, 2013). However, an association that represents the newly established business accelerators is non-existent. Worth to mention is that Flat6Labs (a leading venture accelerator in Egypt) is a member of Global Accelerator Network, which is a networking hub for over 50 accelerators in 63 cities all over the world (Gan.co). This shows that normative determinants would be externally affected by international practices rather than local. Several NGOs, associations, and electronic platforms are working on improving and enhancing the entrepreneurial environment in Egypt. Such initiatives would include, Alexandria Business Association (ABA), Egyptian Junior Businessmen Association (EJB), Middle East Council of Small business and Entrepreneurship (MCSBE), Egyptian Business Development Association, Alrowad, Injaz Egypt, Silatec Egypt, Endeavour

Egypt, TechWadi Egypt and Egypreneur. It is observed that a western, specifically North-American, impact was apparent in entrepreneurship supporting association Egypt. Some of the major associations such as Alrowad and Injaz Egypt were suppored by the USAid with financial and technical assistance. Other international associations such as Ashoka and Endeavour are international associations based in the US. As well as the efforts exerted by Canada's CIDA on promoting SMEs. This could lead to transferring some of the norms of the mentioned countries to the Egyptian entrepreneurship ecosystem. And eventually cascade towards entrepreneurial finance activities especially in the absence of influential indigenous associations. The concept of westernisation in the Egyptian society is already evident through the work of Amin (2000), it was during Nasser's regime and onwards that escalating westernisation took place. It is plausible to add that the age of information technology and globalisation accelerated such concept. Knowingly westernisation is affecting the whole Egyptian society; however entrepreneurship might be further influenced by the foreign financial and non-financial support in the form of developmental financial institutions.

6.7.1.3 Family Enterprises and Governance

According to a PE/VC director:

"First thing we look at is governance because without control things will be messed up... and in Egypt it's the norm not to have governance... very very very few have governance... it's a culture thing... there is no legislation that enforces governance... except for board meetings and activities that people adjust on paper and not really implemented...".

Another PE/VC director argued that lack of corporate governance is the second biggest hurdle that faces their business in Egypt, he added that this is due to the many family businesses that exist. It was discussed that it is very difficult to apply governance in SMEs and same applies to family businesses due to their imbedded culture of control and doing things their own way. Family businesses do constitute to a large number of enterprises in the private sector and even a larger number in the SMEs, according to industry professionals. The family ties and extended family networks culture in the society plays a role in the existence and continuity of family enterprises. It is based on family trusts and support. The culture of supporting family members extends to the children even when they start to work; family dependency was considered as a cultural barrier by policy makers.

"*We have a high family dependency here in Egypt and the type of education! These are all cultural barriers for entrepreneurship"* (Policy maker).

Therefore, lack of governance in general and family enterprises in particular was found a barrier for entrepreneurial financiers to find potential investees.

6.7.1.4 Perception of Entrepreneurship

The perception and status of entrepreneurship would be a contributor to this pillar as it affects the demand side of entrepreneurial finance. Egypt was ranked 12th among the 43 GEM countries with adult population considering entrepreneurship as a career. The adult population perceived status of successful entrepreneurs highly in 2008, which even improved in percentage in 2010 to become the 14th among 59 countries ahead of many efficiency and innovative driven countries (Hattab, 2008; 2011) . With

90% of the Egyptian population believes that a successful entrepreneur gets a high status in the society and 70% thinks the media gives an adequate coverage on entrepreneurs (*op. cit.*). This positive perception on entrepreneurship would encourage the choice of an entrepreneurial venture and thus the inflow of opportunities for entrepreneurial financiers.

6.7.1.5 The Dynamics of Networks

Networks were found to be 'extremely important' in developing countries (Acs and Virgill, 2010). It is argued that networks fill the gaps during institutional transitions in emerging economies (Peng and Zhou, 2005). The absence of formal networks was substituted with informal networks in many aspects of entrepreneurship and its financing tools. Regarding sources of funds, the amount of informal finance and specifically love money among family members might be indicative. Importance of networks and trust was also apparent in deal sourcing activities. Financiers were mostly dependent on a small circle of network, their circle of entrepreneurs, and close friends and family members. This might also explain the geographical proximity towards their investees. It allows them to easily find information on investees from their closed circle. Further observations were found in the cooperative financing among traders and rotational lending. Such networks were based on personally knowing the members of the group and trusted referrals. The level of trust among the networks is paramount and gaining trust was not easily granted. Further explanation on cooperative behaviour in Egypt was through researching the differences among societies. Such differences were extensively discussed in the work of (Hofstede, 2001) which was found beneficial to this topic. Societies range from individualist societies to collectivist societies; individualism indicates that relations between societies are loose, while collectivism is relevant to societies with strong informal relations and cohesive groups (Hofstede, 2001). In the case of Egypt, with a low score of 25 on the individualism index is considered a collectivistic society (Geert-hofstede, 2014). *"This is manifest in a close long-term commitment to the member 'group', be that a family, extended family, or extended relationships. Loyalty in a collectivist culture is paramount, and over-rides most other societal rules and regulations. The society fosters strong relationships where everyone takes responsibility for fellow members of their group."* (Geert-hofstede, 2014).

Although the heavy reliance on personal networks might inhibit the number of business transactions (Peng, 2003), one would suggest that the informal networks would fill the gap and strengthen the ties among groups. In other words, informal networks might have some negative transaction costs, yet they serve as an invaluable substitute in emerging economies with under-developed formal institutions.

6.7.1.6 Indigenous Developmental Organisations

It was also noticeable that local NGOs were involved in the field of entrepreneurial finance. NGOs such as Nahdet El Mahrousa established in 2003 focusing on innovative social enterprises (Nahdet el Mahrousa, 2013), Alashenek ya Balady focusing on economic empowerment of marginalised communities (Alashenek ya Balady, 2013), and Alexandria Business Association offering small sized loans for micro and small enterprises, they all contribute in incubating and financing entrepreneurs. These local charitable and developmental activities may complement government initiatives and compensate for under serving SMEs and entrepreneurs in Egypt. The charitable practices might add to the existing informal finance to attempt fulfil the need of entrepreneurial finance. It was also found that Islamic related NGOs were also involved with entrepreneurial finance. They collaborate with interested parties in supplying small amounts to new venture on equity or Islamic financial tools. The emergence of charitable institutions along the side of informal angel investors and love money are forming parallel informal institutions for lack of alternatives and limited government support. Thus, it is possible to consider developmental and charitable associations a favourable factor contributing to entrepreneurial finance. It could once more be explained as a reflection of the co-operative nature of the societal norms in collectivist societies that might as well be partly influenced by Islamic charity practices (see section 6.7.2.4).

6.7.2 Cognitive Forces on Entrepreneurial Finance in Egypt

The cognitive-cultural pillar explains the beliefs and imbedded cultural values of individuals that are projected on the individual's or societal behaviour (Scott, 1995).

6.7.2.1 Legitimacy of Entrepreneurship

In 2008 the GEM report signalled a very low fear of failure rate ranking Egypt second after Iran indicating a surprising appetite for risk, however it changed to rank Egypt 11th among the 53 GEM countries in 2010 (Hattab, 2011). This is still a positive aspect in Egypt indicating a good mindset for entrepreneurship and low fear of failure. Moreover, it was found that 63% of the Egyptian population believes they have enough knowledge and qualifications to start their own business, however, on the other hand only 25% would consider starting their own business in three years' time (*op. cit.*). Although, it is relatively a high percentage of confidence in having the desired skills, the national experts in Egypt believes that Education is the most important constraining factor towards entrepreneurship. It is believed that the Egyptian educational system on all levels is relatively poor and insufficient, which is reflected in the overall rank falling last on education and training (*op. cit.*). This is again a conflicting indicator between the experts and the general perception of the population. This could be partially explained as an overconfidence stemming from inadequate education and learning process. The general perception could be lacking what are the required knowledge and skills to start a business. The fact that only 25% would consider starting a business might support a fear of starting a business and not a 'fear of failure'. It reflects a fear of the cumbersome regulatory system (elaborated in the regulatory pillar section 6.7.3). Moreover, the inherited culture of the secured state job could still prevail. A state job was a highly favourable option in Egypt till the 1970s when the private sector started to emerge and became widely accepted in the 80s and 90s (Amin, 2000); hence the Egyptian proverb: *"If you cannot have a 'miri' [government] job, wallow in its dust"*. However, it has changed significantly in the society and a 'good family' could now give their daughters in marriage to young men in a private venture, which could have seldom happened in the near past (Amin, 2000: p.73). This falls under the argument of legitimacy as been discussed by Scott (1995) and here it explains whether there is legitimacy for entrepreneurs to start their business or not. Legitimacy towards entrepreneurship in Egypt could be a hybrid between the positive perception on entrepreneurs and low fear of failure on one hand, and on the other hand is the fear of entry and the imbedded attachment to the security of the state job. Further evidence on the cultural barrier was through Hofstede's (2001) 'uncertainty avoidance' dimension as a socio-cultural determinant. Egypt scored 80 on this dimension and thus has a high preference for avoiding uncertainty; *"Countries exhibiting high uncertainty avoidance maintain rigid codes of belief and* *behaviour and are intolerant of unorthodox behaviour and ideas..... Security is an important element in individual motivation."* (Geert-hofstede, 2014). In the case of Egypt, legitimacy to start a business could be well supported; however, the cultural barrier is still evident. This would also affect the general domain of entrepreneurial finance and understanding the cultural mind-set that might inhibit the supply side of entrepreneurial ventures.

6.7.2.2 Significance of Innovation

Entrepreneurs in Egypt can be classified as small and micro business owners contributing to the vast majority of SMEs in Egypt, and the relatively innovative enterprises. The later is more dependent on technology and differentiated ideas than the rest of the market. Still, the vast majority of this category follows a 'me too' model imitating international successful ideas. Most of the nascent enterprises tend to be in the sectors of retail, hotels/restaurants and whole sale trading with a general tendency towards services with a greater tendency to business services rather than personal services (Hattab, 2008). As for innovation and growth expectations, Hattab (2008) indicated that the vast majority of the businesses in Egypt are not technology-oriented nor differentiated in their product market combinations leaving the country in the bottom four of the GEM countries in 2008. It was argued that in HGEs, innovation and not high technology that determines high growth of enterprises (OECD, 2013).

Egypt was ranked 120th out of 148 countries in the Global Competitiveness Report (2013-2014) for the innovation pillar, earning 2.8 on a scale of 1 to 7 (Schwab and Sala-i-Martin, 2013). Noticeably, within the factors of innovation pillar 'Availability of scientists and engineers' was ranked 55th. Policy makers do admit that innovation needs larger efforts, though many initiatives are already taking place. According to a policy maker:

"It is the most important issue; it is affecting the whole topic [entrepreneurship] and accordingly the industry [entrepreneurial finance]. Lack of innovation and entrepreneurial spirit is a big hurdle...".

A PE/VC director echoed the same concept, he argued that the culture in Egypt is not ready and it can't be compared with South-East Asia. He added that is very difficult to support an entrepreneurial finance sector in Egypt with the current mind-set; innovation is totally missing and supporting universities, innovation and entrepreneurial education is the best way forward. Industry professionals see that there is a lack of synchronisation between innovation programmes and very little awareness exists even among the different programmes themselves. They also suggested that innovation needs to be tackled in the early stages of university education.

Entrepreneurs shared the same point of view and agreed that innovation programmes should be introduced at university level and a greater attention should be given to the commercialisation of innovation. According to Xavier *et al.* (2013), an economy has to invest in R&D and innovation for entrepreneurs to be 'agents of creative destruction' and that policy addressing firm creation alone without investment in education and innovation will not help in economic growth. In GEM reports on MENA (Stevenson *et al.*, 2010) and Egypt (Hattab, 2008), it was clear that most entrepreneurial ventures are neither innovative nor technology based. Research and Development (R&D) and Transfer ranked Egypt last in 2008 and 50th in 2010

(Hattab, 2008; 2011). Noticeably, according to the Global Competitiveness Report, the ‘Quality of scientific research’ was ranked 127th, ‘Company spending on R&D’ 123rd, ‘University industry collaboration in R&D’ 133rd, and Government procurement of advance technological products 116th out of 148 countries (Schwab and Sala-i-Martin, 2013). From the policy makers’ and industry professionals’ perspectives, entrepreneurship should include a high innovative component to be appealing to entrepreneurial financiers. It is suggested that limited innovation might affect the strategies and sector choice of entrepreneurial financiers.

6.7.2.3 Islamic Influence

The influence of *Shari’a* was evident along the cycle of entrepreneurial finance, from source of finance selection, to the operations of the venture itself. Source of finance were inclined toward equity rather than debt. Besides the other reasons of fear of bank regulations or the reluctance of banks to finance SMEs, there was a tendency to prefer ‘partnership’ over bank debt. It was also found that the importance of *Shari’a* compliant financing was relatively more important to the individuals/entrepreneurs than it was to the industry professionals and financiers. Most of the industry professionals, contrary to the entrepreneurs, did not address the Islamic finance issue unless they were explicitly asked for its impact on entrepreneurial finance. Interestingly, they almost all agreed on its significance and that it could support many financing tools such as leasing, crowdfunding and venture capital. It was noticeable that the Islamic finance influence varied among social classes and ideologies. Islamic finance model prohibits interest based loans and emphasises on risk sharing in the form of partnership. The mechanism and impact of Islamic finance on Egypt on entrepreneurial finance domain will be later elaborated in section (7.6). The findings emphasise the importance of this aspect in Egypt and partly explains the preference of equity financing by entrepreneurs over debt financing, particularly banking debt finance. Although it is hard to generalise the effect of Islamic finance on all businesses in Egypt, yet a 'noteworthy' outcome, from primary observations and estimations by industry professional, would prefer Islamic banking. Generally, it was noticeable that in less developed countries with a Muslim majority have a strong reservation about receiving or paying interest, and they choose personal sources of funding or Islamic tools over commercial banks (Stevenson *et al*., 2010). The Islamic cultural component might support the development of equity financing tools in general, and angel, crowdfunding, and VC, in particular. Therefore it would be considered as a contributing cognitive factor in support of entrepreneurial finance in Egypt.

6.7.2.4 Charitable Practices

In addition to Islamic finance, the charitable nature of Islam is clear in the notion known as *'Zakat'* (alms) which is a religious obligation on all financially capable Muslims to give a small portion (usually a 2.5% annually) of his wealth to the poor and less privileged and *'Saddaqah'* which is a voluntarily act of charity with no set amount yet highly religiously rewarded (Kochuyt, 2009). Besides the two mentioned charity acts of Islam, there is the notion of *'Waqf'* where someone would dedicate a certain amount of their wealth for a social cause usually in the form of land or building for the purpose of building mosques, schools, orphanages, or charities; all the above forms of charity in Islam are being used in modern days in forms of charity activities and social welfare of the Muslim societies (Clark, 2004). This kind of practice has an effect on the contribution of NGOs towards financing entrepreneurs and also might partly explain informal financing and motives behind ‘love money’ among extended family members.

6.7.2.5 Problem Solving Behaviour

The researcher’s early interviews with PE/VC firms in 2008 signalled lack of entrepreneurial opportunities and ideas, yet it was noticeably decreasing towards later interviews in 2011 onwards. Research observations would suggest that many of the new innovative enterprises in Egypt were ‘technology enabled’. This term was used by VCs and entrepreneurs alike, the new social networks and mobile applications helped them develop businesses that are differentiated, relatively innovative, and using new technologies to reach new clients. Most of such new ventures were focusing on solving local problems, such as traffic updates and news platforms. Other ventures focused on design such as personalised and interactive designs in furniture and apparel. The ‘technology enabled’ ventures were attempting to substitute the lack of breakthrough innovative technologies which needs significant R&D and substantial investments with a simpler model to create value via differentiation. The scene of entrepreneurship is rapidly changing, more noticeable after the January revolution and in the whole region after the Arab spring uprisings. In November 2013, the Mayor of London announced an intention to launch 100 million GBP fund dedicated to entrepreneurs and innovators from Arab and Muslim world (Taylor, 2013a). This might be a realisation of the current momentum that is happening in the region. The current technologies and communications have facilitated the connectivity among entrepreneurs and the easiness to employ technology in their everyday life and problem solving. According to Schroeder, author of “Start-up Uprising” exploring entrepreneurship in MENA region *“I realised that I had been stuck in my own* *narrative trap about hopeless cycles of violence and corruption in the Middle East. When I went there and looked for myself, I saw just how much the new infrastructure of connection makes possible, even when the larger structures are crumbling. I began to see how the enormous potential of bottom-up problem solving is taking hold and changing everything"* (Joni, 2013). Schroeder (2013) argued that top-down institutions have problems understanding the nature of many problems; he suggests that local entrepreneurs on the ground are more capable in solving their own problems. Moreover, the unprecedented technological advancement, in particular social media, and mobile devices are changing the power dynamics. Hence, bottom-up problem solving and innovative approach based on local knowledge and application of new technologies to solve indigenous problems was found valuable in Egypt and the MENA region entrepreneurship. This research suggests the problem solving nature of the Egyptian entrepreneurs to be a conducive cultural aspect enhancing entrepreneurship and entrepreneurial finance in Egypt.

6.7.3 Regulatory Forces on Entrepreneurial Finance in Egypt

Regulatory institutions are the legal and governmental institutions that regulate the industry (Scott, 1995). They are mostly the reward and punishment policies applied by governments based on economic incentives; they contain regulations, industry agreements, and industry standards (Scott, 2007). It is evident that economic policies and regulatory matters as well as incentives do affect the decision to launch new ventures in different economies (McMullen *et. al.*, 2008). According to Scott (2002), the regulatory dimension is the easiest to change and is very well observed as an institutional determinant.

6.7.3.1 Business Environment

According to O'Sullivan *et al*. (2011), the MENA-OECD Investment Programme Working Group on SMEs and Entrepreneurship substantiated three main factors restricting entrepreneurship in MENA region: *'First, high barriers to doing business, particularly for smaller firms (e.g., corruption, complex licenses, rigid labour laws, high taxes, and unfair competition); second, cultural norms in which entrepreneurial activity is seen by young graduates as second-best compared with employment in the public sector, which offers more job security; and finally, the very low participation of women in the labour force and in entrepreneurial activity'* (O'Sullivan *et. al*., 2011: p.7). Egypt is no exception regarding its business climate and regulatory framework (see section 3.3). This would directly affect entrepreneurial finance and how they do business with investee companies. This effect would be on the legal setup of the entrepreneurial financiers, the setup of investee companies, business permits and licensing, regulations on bankruptcy laws, intellectual property rights, taxation (in investee companies and financiers), and the enforcement of laws and contracts. Another PE/VC director indicated that the main factors hindering the development of entrepreneurial finance were government corruption and the lack of a consistent regulatory and strategic vision; he added that the government bureaucracy and the time needed to establish companies was very time consuming compared to other MENA countries. An industry professional argued:

"the external factors that don't help supporting the SMEs are regulations, taxation, and surprisingly the understanding of the different bodies that claim they are supporting SMEs, don't understand SMEs".

Many studies had found that a supporting legal framework and low level of corruption are highly important to develop entrepreneurship (Li and Zahra, 2012); moreover, it will affect the quality of entrepreneurs and thus will deter high growth entrepreneurial entry rates and the employability of those companies (Xavier *et al*. 2013). It was found that many entrepreneurs and financiers opted to establish a mixed model of on-shore/off-shore to overcome the complications of establishing companies and funds. Others signed shareholders agreements (SHA) under foreign regulatory laws to protect their rights and ensure law enforcement. However, dealing with corruption, which most studies pointed its high impact on business and entrepreneurial finance (Bergara *et al.*, 1998: McMullen *et al.*, 2008), and intellectual property rights were still problematic. Once again the red tape to start a project and acquire the essential licences is not supporting the entrepreneurship ecosystem in Egypt. The cumbersome and complicated labour laws, multiple taxations, and social insurance laws are creating entry barriers for entrepreneurs. Moreover the legal consequences in cases of dissolving or bankruptcy are very high, which is argued in this research to create a fear of entry rather than an entry barrier. Further investigation on bankruptcy laws due to their significance are discussed in the following section.

6.7.3.2 Bankruptcy Laws

Armour and Cummings' (2006) work on legal aspects on VC in Silicon Valley, and the effect of bankruptcy laws on entrepreneurship in Europe and North-America (2008), found that 'forgiving' personal bankruptcy laws that are more 'entrepreneur-friendly' had a positive effect on the rate of self employment in tested markets and accordingly the level of entrepreneurship. They argued that it was more statistically significant than economic determinants. Relating to Kirzner's (1997) arguments on the role of entrepreneurs, where most of the time markets are in disequilibrium due to errors caused by other entrepreneurs and the alert and imaginative entrepreneur takes the opportunities and act to correct the market. Hence learning experiences from failure and success is suggested to be a prerequisite for a vibrant entrepreneurial environment. Accordingly it is plausible to suggest that forgiving and speedy bankruptcy laws enabling entrepreneurs to start their business quickly and efficiently would create a vibrant entrepreneurial activity.

Further investigation regarding the Egyptian bankruptcy laws took place. According to a legal industry professional, the laws on bankruptcy in Egypt were applicable on traders who proves incapable or in the risk of being incapable of paying off their debts. The court of law manages the assets of the trader by assigning an agent on behalf of debtors. He indicated that the process of bankruptcy are lengthy and can take years to resolve. Furthermore, the declared bankrupt trader is punished by being prohibited from any trading or investment activities and loses his political rights and according to the law is not entitled to witness in courts of law. He further added that bankruptcy laws can also be applied on chairpersons and CEOs of limited liability companies, as well as all board members who are proved actively managing the company. The bankruptcy laws are capable of imprisonment punishments if the trader was found fraudulently or intentionally bankrupt his trade. It was found possible for a trader to reclaim his commercial and social rights after three years of paying off his debts. The industry professional commented that the law is relatively harsh and outdated. Furthermore, the minister of investment and the chair of the SFD pointed that there was a real need to revise bankruptcy laws in Egypt. In fact, they indicated that a project of a new law was ready and should be soon submitted for approval from the parliament. However, it has been delayed due to the political situation and priorities of the current government.

The current bankruptcy laws are considered a major regulatory hurdle and the need for an 'entrepreneur-friendly' bankruptcy law is eminent. According to academic studies, entrepreneurship reports, industry professional, and policy makers, a new 'forgiving law' is believed to support entrepreneurship in Egypt.

6.7.3.3 Laws Governing Entrepreneurial Finance

During the course of this study, it was found that there are no laws or regulations that govern crowdfunding in Egypt. The same applied to business incubators or accelerators as well as PE/VC firms. The only law which was supposed to govern PE/VC is law no.95 for the year 1995, yet very few of the active PE firms and none of the VC firms work under this law.

According to a PE/VC director:

> *"The problem with the PEs in Egypt is that the legislation does not confess its existence. They only know investment companies and holding models, equity (stock market) funds... yet PE for them does not exist... the risk capital law is an investment company with specific goals, I established one before and it's a normal company with a paid in capital of 10 million pounds (EGP)... it has no privileges what so ever"*.

Moreover, there are no laws that would promote angel investments or rewarding for the risk taken by VC investors. There were also no laws that exempt for capital gain taxes for angels or VCs. Further discussion on the importance of those regulatory aspects on the VC industry will take place in section (7.5.3).

6.7.3.4 Intellectual Property Rights

According to the Global Competitiveness Report 2013-2014 Egypt was ranked 94th over 148 countries on IP rights protection (Schwab and Sala-i-Martin, 2013). The weak rule of law and intellectual property rights laws are adding to the burden of starting new enterprises. One PE/VC director indicated that IP rights and trade mark registration was a major hurdle. It was observed that most of the entrepreneurs perceived IP rights highly complicated in Egypt and that the procedure to acquire a patent was very lengthy and tiresome. From field observations, some of the entrepreneurs opted not to go through this procedure in Egypt in the first place. This group of entrepreneurs could afford to register their company in Europe to make sure that they are able to protect their patent according to international laws in a reasonable time frame, according to them. It was found that this was an option for many other entrepreneurs in Egypt with valuable innovative ideas.

6.7.3.5 Financial Sector Development

There were apparent efforts from the Government of Egypt over the past two decades to improve its financial sector. Starting with the banking sector reform, introducing new SME banking CBE regulations, all through establishing a credit rating company and credit guarantee factoring are positive steps towards enhancing the banking sector and SME banking in specific. Furthermore, new programmes were established on equity and debt financing to support entrepreneurship and SMEs, such as SFD, NILEX**,** and BEDAYA centre. The promotion of leasing, factoring, mortgage, among other EFSA supervised non-banking financial activities were also evident. According to industry professionals and development reports (OECD, 2010a;

2010b), although the impact of these efforts were not up to expectations, they are anticipated to have a larger impact within a larger scope of regulatory reforms.

6.7.3.6 Technology Infrastructure

Among the regulatory efforts and governmental initiatives are the promotion of the ICT sector and the infrastructure developed for this industry (STFD, 2012). Furthermore, innovation support through technology funds and universities were also evident yet highly inefficient and limited, according to industry professionals. However, they remain evident attempts of the efforts undertaken by the government and thus a platform that can be enhanced and built upon to promote entrepreneurship in Egypt.

6.8 Conclusion

Table (6.1): Institutional Forces Affecting Entrepreneurial Finance in Egypt

	Normative forces	*Cultural-Cognitive Forces*	*Regulatory Forces*
Obstructive Factors	1- Poor level of Education, training, and entrepreneurship education.	1-Weak legitimacy towards entrepreneurship career.	1- Unfavourable and cumbersome business environment and weak rule of law.
	2- Lack of professional associations and westernised influence.	2- Low levels of innovation.	2- Unsupportive bankruptcy laws toward entrepreneurship.
	3- Abundant family owned enterprises and lack of governance.		3- Lack of inviting laws governing entrepreneurial finance.
			4- Inefficient intellectual property rights laws and protection.
Conducive Forces	1- Positive perception towards entrepreneurship.	1- Islamic finance influence supporting risk taking and equity financial tools.	1- Efforts on restructuring and development of the financial sector.
	2- Viability of informal networks compensating lack of formal.	2- Charitable practices induced by Islamic and cultural behaviour.	2- Attempts on creating a favourable ICT infrastructure.
	3- Indigenous developmental organisations supporting the domain.	3- Bottom-up problem solving behaviour.	

An institutional analysis on entrepreneurial finance in Egypt showed that normative, cultural-cognitive, and regulatory forces shaped the domain with both obstructing and supporting determinants. Illustrated in table (6.1), institutional forces are grouped into conducive forces and obstructive forces. The table summarises the findings on the general domain of entrepreneurial finance in Egypt using an institutional theory framework and thus answers the first question of this research "What are the main institutional determinants shaping entrepreneurial finance in Egypt?"

The findings regarding the first question of this research suggest that all institutional determinants are intertwined and have multiple effects on the different determinants. It remains plausible to argue that the regulatory pillar is held most accountable for the under development of entrepreneurial finance in Egypt. The normative and cognitive pillars both have supportive and inhibiting factors. However, the overall effect of normative and cognitive pillars could be positive if policy makers were able to factor in the cultural and normative forces in policies promoting entrepreneurial finance.

Chapter Seven: Discussions on Venture Capital in Egypt

7.1 Introduction

This is the second and final chapter on the findings and discussions of this thesis. It will be summarised along with previous findings in following concluding chapter. After exploring the entrepreneurial finance environment in Egypt in chapter six, it became perceptible that a thorough investigation on the VC activities was necessary to further study the opportunities of a VC industry in Egypt as a fundamental component of entrepreneurial finance. An overview on the evolution on the PE/VC industry in Egypt was found important to understand the industry. It is followed by further analysis of the current situation and prospects for the VC industry in Egypt in the light of existing literature on VC worldwide expansion and behaviour. The chapter is divided into two sections, first is an overview on the VC industry in Egypt and the second section is an institutional framework analysis for the VC industry in Egypt.

The first section will be grouped in two categories, macro-perspectives of the VC industry and micro-perspectives of the VC industry. The macro-perspectives will include the current regulations and policies that are shaping the VC industry. Regarding the micro-perspectives, a study on the current behaviour of the VCs in Egypt and the current institutional forces shaping their behaviour and investment decisions. It will be followed by situating VC activities within the Islamic finance domain for its perceived impact on Egypt and the region. Finally, discussions on opportunities for a VC industry to develop in Egypt are presented, in the light of policy recommendations.

7.2 Venture Capital in Egypt

According to the Egyptian Financial Service Authority (EFSA), currently there are 19 licensed Venture Capital firm under the law 95 for year 1995 governing financial services (EFSA, 2013). However, most of those firms were found inactive and were subsidiaries of banks and other holding companies that acted as special purpose vehicles. The Arabic terminology for venture capital is word-to-word translated to 'Risk Capital' and thus the law would cover PE investments as well as other investment vehicles. The key Private Equity firms in Egypt are Citadel, EFG-Hermes, Beltone Capital, Grand View, Al-Ahly for Development and Investment (ADI), Nile Capital, Actis, and Concord. Only three companies covered SME financing: Beltone capital as it manages an SME fund, ADI which also manages BEDAYA fund initiated by Ministry of Investment (MoI), and Grand View which focuses solely on SMEs. However, other than Nile Capital, none of those companies directly finance star-ups and early stage entrepreneurs in Egypt. Only two of the mentioned PE firms are licensed under Egyptian law, and the remaining licensed firms are either bank owned investment companies, or privately held investment companies. The second set of companies that finance high growth innovative start-ups and/or early stage entrepreneurs are separately identified as follows: Sawari Ventures, Ideavelopers, Tamkeen Capital, Sofico, and Nile Capital. Noticeably, none of the five VC firms are regulated under the 'risk capital' Egyptian law.

The evolution of the VC industry started in the late 1990s with the establishment of Al-Ahli for Development and Investment (ADI). According to industry professional and PE/VC directors, ADI was the pioneer initiative for VC in Egypt. However, it was indicated that it was not a great success and it might have affected the growth of the VC industry as it became negatively associated with this experience.

Another initiative was IT-Ventures which stemmed from ADI and managed to raise ‘considerable’ funds, however, its success was once more perceived to be limited. Around the years 2003/2004 there was a second wave of larger PE firms that were primarily exploiting the privatisation process taking place at that time by the Egyptian government. Their activities solely concentrated on late stage, mature, and large opportunities. Some of those companies turned out to be a huge success and managed to raise ‘substantial’ amounts of funds, especially from the GCC. The PE industry continued to grow until there were limited opportunities left and hence jeopardised the sustainability of the model counting on privatised firms. By early 2000s, the Government of Egypt (GoE) started to support funding for SMEs and promote innovation on the demand side. GoE with one of the leading investment banking firms established ‘IdeaVelopers’ to manage a public fund initiated by the Ministry of Communications and Information Technology (MCIT). The size of IdeaVelopers’ fund is 265 million EGP (approx. 25 million GBP). It solely focuses on IT solutions and collaborates in many projects with MCIT. Other small initiatives took place starting from 2005/2006 from private family investors. Those firms were a hybrid of BAs and VCs and were capturing the need and opportunities for SME financing. Furthermore, some of the PE firms established separate funds to cater SMEs; however, they were still inclined towards medium enterprises. After the January revolution, a new set of VC financiers emerged, along the side of business incubators/accelerators and business angels.

It is possible to group VC/PE firms in Egypt into three categories. The first group would be pure PE, solely catering late stage and large opportunities. The second would be a hybrid of PE/VC firms; those are PE firms that consider early stage financing and/or SMEs. The third group would be firms solely financing early stage and SMEs; those would be a hybrid of VC/Angel or VC firms. The hybrid VC/Angel firms are mostly business persons and family offices that invest in start-ups and early stage with some level of habitual systematic behaviour, yet they don't necessarily plan on exit scenarios. In addition, VC/Angels would in most cases manage their own funds and resources. It was found that one of the VC firms integrated an accelerator programme. In general VC firms managed their own funds and funds on behalf of HNWIs and Institutional investors. This set VC firms had emerged right before the revolution and became more evident and visible after the revolution. The primary data of this research has been built on the second and third category of the VC/PE firms in Egypt for their relevance to the topic of entrepreneurial finance.

It was noticeable that in early interviews (before January, 2011 revolution) concerning opportunities for VC development in Egypt, PE/VC directors and industry professionals identified that lack of business incubators are a primary cause for lack of opportunities and thus inhibits VC industry to grow. There could be some complementarities between incubation and venture capital industry (Callegati, Grandi, and Napier, 2005). In fact, the concept of business incubators is not novel to Egypt, it started with the governmental Social Fund for Development (SFD) as a national programme (STFD, 2012). After the January revolution, the landscape of venture incubators had dramatically changed, and there is a growing interest in accelerators programmes. One of the leading initiatives, holding the largest no. of graduates is 'Flat6Labs'. It is a joint venture of 'Sawari Ventures' (A venture capital firm in Egypt) and the American University in Cairo (AUC). Flat6Labs funds technology and technology-enabled start-ups, it accommodates 36 ventures enrolled quarterly in an exchange for a minority share of 10 to 20% and an investment of 10000 to 20000 USD (Flat6Labs, 2013). They currently expanded their operations regionally to open a second accelerator in Jeddah, Saudi Arabia with further expansion in plan. Even though the AUC collaborates on Flat6Labs, it started its own incubation project in 2013 ‘The AUC Venture Lab’. It is the first and only on campus business incubator in Egypt. They select 3 to 5 companies per cycle twice a year and the business has to be highly innovative to provide place and funding (AUC, 2013). There are other smaller initiatives such as ‘Tahrir Squared’ which started in April 2011 in Alexandria and they position themselves as ‘Technology accelerators’ (Tahrir2, 2013). As of April 2012, they have launched two companies; however they deliver mentorship and access to finance to over 10 companies per intake (Tahrir2, 2013). Other initiatives are also taking place at the time of this research. A new accelerator named ‘JuiceLabs’ was announced to open in early 2014 (Taylor, 2013b). The software focused ‘Juice Labs’ plans to incubate four start-ups each year, and will receive 22,000 USD in funding for an equity stake not to exceed 15% (Taylor, 2013b). The latest initiative was the ambitious project of “Tahrir Alley Technology Park” (TATP). It is another initiative by the founder of Sawari Ventures and Flat 6 Labs. The founder leased a downtown (close to Tahrir square) unutilised famous campus of the American University in Cairo, the Greek campus which was later rebranded as GrEEK. The founder envisions TATP to become the mini Silicon Valley of Egypt. (El Dahshan, 2014).

Graduating from an accelerator might provide a venture opportunity for VCs; however, it does not ensure funding for the entrepreneur. An entrepreneur argued that even ventures that graduated from prominent accelerators could not raise any VC funds in Egypt. He added that without funding, Egypt will end up with plenty of promising prototypes that would never be able to scale up. The need for a vivid VC industry was argued to be essential for the entrepreneurial ecosystem. The trend towards entrepreneurship in general and business accelerators in specific in Egypt is growing at a high pace. However, for how long this will stay and their impact on entrepreneurial finance and VC in Egypt needs further assessment in the future.

According to a policy maker:

"VC is still a very new concept in the Egyptian market, it is considered in its testing phase. Though there is perceived demand, there is less awareness about the concept from both sides of demand and supply… There is a relatively higher interest in the [VC] mechanism following the revolution, which could be noticed from the new funds that are established".

Regarding the reasons for the increasing interest in VC, an industry professional indicated:

"Nowadays there is an acceptance for this idea (VC)… especially with the more educated youth… and are more open on the west especially those who work in technology… all those interested in IT would look at what Google or Facebook did... how it starts with an angel and then a VC and a larger VC and so on till IPO… it showed them that these are the means for bigger money".

On the other hand, a director of an already existing PE/VC firm saw that the January revolution actually hampered the growth of the industry that was "rapidly" improving; he added that it was much harder to work under such economic and political circumstances throughout the whole cycle of the VC/PE operations. An industry professional argued that after the January revolution, and for the past three years the PE industry is dead, there are no realistic opportunities and the current economic situation is adding to the pressure. He noted that the global financial crisis right before the revolution was another factor where PEs are struggling with in fundraising activities and exit. He pointed that the future in Egypt is for SMEs and entrepreneurial finance; with the reluctance of PEs to increase their scope to accommodate SMEs they won't be able to survive.

From a demand perspective, entrepreneurs had a positive outlook towards venture capital as a mean of raising capital for their new projects. An entrepreneur mentioned that venture capital can help grow a business at faster pace than conventional sources of finance, providing that a VC firm guides the entrepreneur yet their advisory services should not be compulsory.

"VC will be very useful when the entrepreneur is not eligible to take a loan from the bank..." (Entrepreneur).

Regarding the concern over control, an entrepreneur argued that VC is much better than conventional partnership hence more or less it's a temporary partnership and VCs would exit at some point when the business matures. However, an overall appreciation for the strategic value adding services of VCs was observed.

"The VC firm will provide help through consulting services, marketing services and new ideas" (Entrepreneur).

It was noticeable that not all entrepreneurs, specifically in non-technological ventures, were aware of the nature of VC firms; although they might have heard of the term before. When the nature of VC was introduced, the majority gave a positive feedback. An entrepreneur argued that many of the traditional industries here in Egypt still yield very high rates of return, and he believed that VCs should be interested in non-technological ventures in Egypt. Another cultural dimension was raised by an entrepreneur who is a second generation in his family's business. He indicated that things are changing now and people are becoming more profit oriented and emotional attachment to businesses is considered a thing of the past;

"What I care about is to maximise my wealth, my father wouldn't have thought the same... he is very reluctant to partnerships".

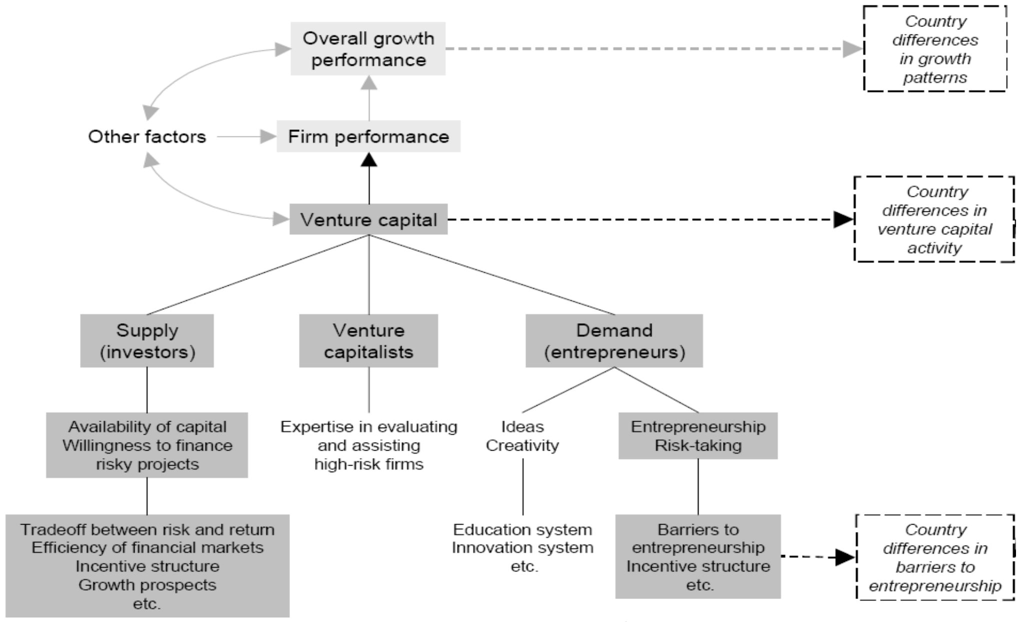
It is plausible to argue that there is a demand for VC in Egypt. Supported by findings of El-Said (2010) indicating that 92% of the interviewed SMEs would prefer a venture capital over debt type of financing and the study by El Kabbani and Kalhoefer (2011) with over 32% responded with yes for considering VC as a mean of finance and over 51% with maybe while only 8% answered no or don't know. Further investigation on the opportunities for a VC market in Egypt takes place in chapter seven. It explores the current macro-perspectives on the market level and micro-perspectives on the firm to further understand the prospect of this industry in Egypt.

7.3 VC Macro-perspectives: Industry's' Growth Patterns

7.3.1. Macro-level Determinants

This part examines the VC industry in Egypt from a macro-level perspective. The findings are discussed in relation to the literature on country differences in VC development patterns worldwide. Many scholars and developmental organisations had drawn together the determinants of VC growth. Baygan and Freudenberg (2000) emphasised the significance of supply of capital willing to finance risky enterprises, existence of promising ideas and suitable high potential entrepreneurs, in addition to sufficient number of specialists with the necessary expertise to evaluate and fund high risk ventures. They argued that government policies must address these concepts to enhance its VC industries; accordingly, different implementation strategies are the primal cause for country differences in growth patterns. Figure (7.1) identifies three aspects causing country differences, differences in growth patterns, differences in VC activity, and differences to barriers to entrepreneurship.

Figure (7.1): Simple framework of underlying factors and the impact of VC



Source: (Baygan and Freudenberg, 2000), [N.B: in grey are the covered areas of their research]

Furthermore, Kenney, Han, and, Tanaka (2002) in their report to the World Bank on the VC industry in East Asia, identified conditions and preconditions for a VC industry to succeed. They have built their criteria on the successful US industry and relatively successful Taiwanese and Israeli industries to evaluate Asian nations. Another OECD report on risk equity by Thomson and Wehinger (2006) concluded analogous concepts affecting the rates of development of VCs in different countries and suggested public policies to enhance its growth. The former set of work signals a consensus regarding influences on VC development.

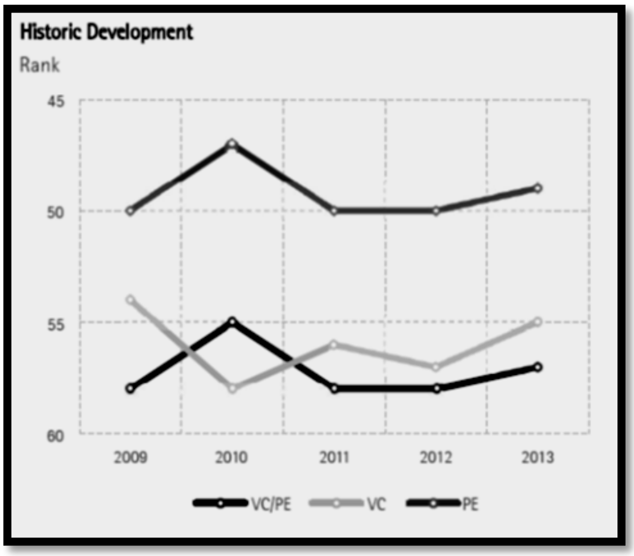
Extracting the common themes from previous research identified the major institutional forces shaping the VC in Egypt. The main themes are as follows, first the demand side: **1**) Entrepreneurial activities, idea generation and willingness to take risk. **2**) Investment opportunities that yields high returns in short time. And from the supply side: **3**) Sources of funds willing to take high risks, especially pension funds. Regarding the environment and its institutions: **4**) Strong capital markets and second tier markets to facilitate exit. **5**) Legal environment and government policies regarding law enforcement, tax incentives, shareholders minority rights and bankruptcy laws. **6**) Political support and VC industry awareness. **7**) Technology base and clusters. **8**) VC specialists that are capable of handling VC investments, and finally **9**) Excellent universities that implement high technology research. The nine main themes set as the major institutional forces shaping the VC industry worldwide are used as guidelines in the analysis of the VC industry in Egypt in this research.

7.3.2 VC/PE Attractiveness Index

The previous macro- level determinants were also covered in the work of Groh, Liechtenstien, and Lieser (2010) in developing a VC/PE index to assess country attractiveness. Groh *et al*. (2010) started the VC/PE country attractiveness index with 27 European markets. Their efforts were to quantify the VC/PE determinants and rank their readiness accordingly among other economies in the world while benchmarking to the US market as the 100% of the index. Groh and Liechtenstien (2012) were introducing more emerging markets to the set of countries as well as an increasing number of other countries across the world. They grouped the criteria of a VC/PE success factors into six sub-headings, each representing one of six “key drivers” of country attractiveness for VC/PE investors as follows: Economic activity, depth of the capital market, taxation, investor protection and corporate governance, human and social environment, entrepreneurial culture and deal opportunities. In the 2013 report, it included 118 countries from all over the world; they have also disaggregated the PE from VC while keeping a third PE/VC overall index (Groh *et al*., 2014). According to this index, Egypt was ranked 57th out of the 118 economies included. Surprisingly, it improved from 58th in 2009 and 2011 rankings albeit the economic and political turbulences. It performed best in the depth of capital market and economic activity, while it performed worst on human and social environment, taxation, investor protection and corporate governance.

The Index showed that the PE industry in Egypt had higher readiness than the VC industry. It also showed that in 2009 both the PE and VC were close, while in 2010 an apparent gap for PE development and a sharp decline in VC readiness took place. In 2011 the gap decreased as the PE declined and VC started to pick up. From 2012 till 2013 both indices were improving with a higher growth for the VC readiness. Graph (7.1) is an illustration of both indices separately and aggregated.

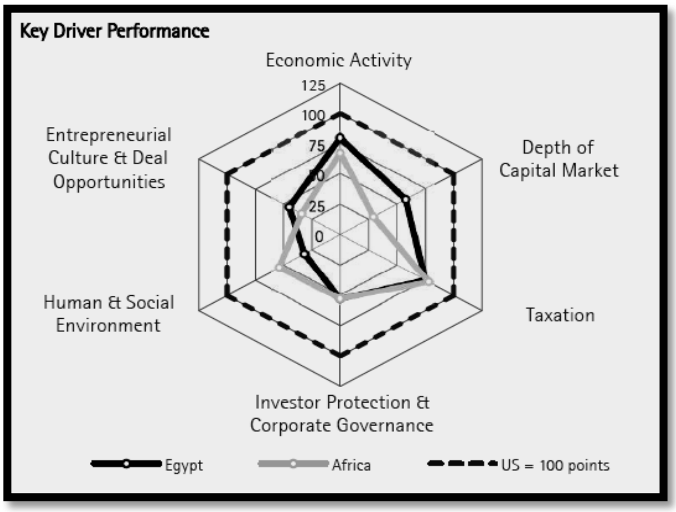
Graph (7.1): Historic development of PE and VC index in Egypt



Source: Groh *et al*., (2014)

In a comparison with the African continent performance, Egypt over performed in depth of capital market, economic activity, entrepreneurial culture and deal opportunities respectively. It matched the average performance of Africa on taxation, investor protection and corporate governance; while it underperformed only on human and social environment. The following diagram (7.1) shows where Egypt stands in comparison to the African market and benchmarked to US.

Diagram (7.1): PE/VC index of Egypt in comparison with Africa



Source: Groh *et al*., (2014)

It was evident that Egypt was the last in the North African region, apart from Libya which was not included in the index, and was ranked 7th on the 10 MENA region countries included. In the MENA region Saudi Arabia was ranked first among the region and 26th in the world, followed by UAE 34th, Oman 46th, Bahrain 49th, Tunisia 50th, and Morocco 55th. Egypt outperformed Jordan which was 58th, Kuwait 61st, and Syria 100th. This was also evident from the interviews with PE/VC directors and industry professionals. They agreed that Egypt's PE/VC industry is less developed than the rest of the MENA region. One industry professional argued that it is more developed yet less regulated.

A PE/VC director indicated:

"The VC industry as a whole is lagging behind most of the MENA region if not all of it. If one compared the population to the number of funds in many of the MENA region, Egypt will be surely in the bottom. Yet the size of funds [in other MENA] is usually far smaller than the targeted funds in Egypt. Tunisia, Morocco, Jordan, Qatar, Lebanon, Dubai, and Saudi Arabia are all ahead of us [Egypt]…".

Egypt is one of the largest recipients of PE investments in the region. The PE industry in the MENA region had always invested across the whole region, with a majority in Egypt for its well developed and mature economy (Morales *et al*., 2011). However, PE firms in Egypt are highly dependent on funding from the GCC. Thus it shows its connectivity to the region in regard of PE and VC and the vulnerability and dependency of the industry in Egypt on the GCC.

7.3.3 Sources of Fundraising

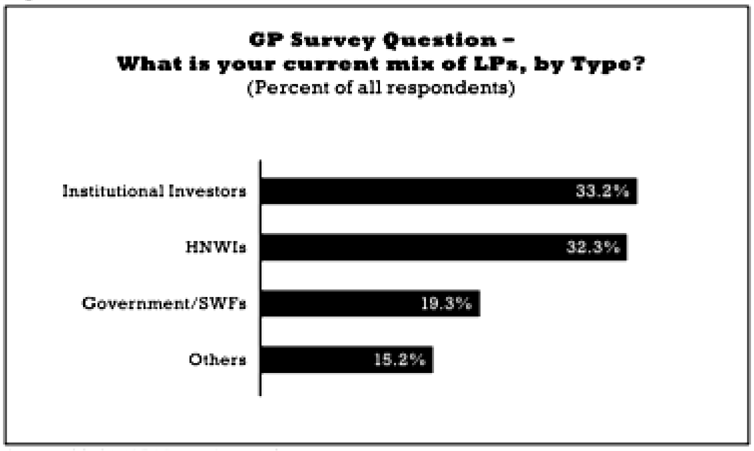
From a VC supply side, sources of funding are found an important differentiating component for VC industry growth. According to Mayers *et al*. (2005) fund sources were found to affect the investment patterns of VCs across countries of Germany, Israel, Japan, and the UK, though not the major explanation for VCs activity differences. In addition, Megginson (2004) found that pension funds are one of the main sources of VC funding thus an important distinguishing factor across countries. According to Ooghe *et al.* (1991), the most important source of funding in Europe was Banks, predominantly Swiss VCs while almost absent in Denmark, Ireland and UK, followed by pension funds and insurance companies. Moreover yet again, favourable capital gains tax rate was an important element in increasing supply of capital to VC industries (Gompers and Lerner, 2001). Fund raising in Egypt was found to be highly dependent on HNWI and primarily from the GCC countries. Figure (7.2) shows that this is also true for PE/VC in MENA region; it shows that institutional investors are almost equal to HNWI which is a unique aspect for the region. In the case of Egypt pension funds were not allowed to invest in PE or VC activities, according to VC/PE directors. It might be due to the reason that they are not regulated or because of the bad experience of heavy losses of the pension funds in equity stock markets. Regarding the VC industry Egypt, it was found that the newly established VC funds rely heavily on personal sources of funds by the fund managers. This had a crucial effect on their growth capacity and deep pocket capabilities required for their success. The PE/VC firms indicated that their primary source of capital was HNWI except for Ideavelopers, which is government backed and funded through banks. Ideavelopers might be the only VC case that managed to raise funds via local banks. According to a PE director:

"The biggest source of investors is from high net worth individuals it's like a 60 to 70% of HNWI to 30 to 40% institutional investors... I know this might be specific to the region… it is because you don't have a strong institutional investor… banks are there but they don't enter PEs… In the region only Egypt would have a proper pension fund and they are not entitled to invest in such vehicles…we have many HNWI in the GCC, plenty... Saudis, Emiratis, Kuwaitis, Qataris, and Egypt... but HNWI in Egypt are not many... or those who would invest in PE..".

This was almost the case with all the PE/VC firms. It also shows the differences among HNWIs in the region; HNWIs from the GCC would accept investing in PEs or VCs while the HNWIs in Egypt would tend not to. The Egyptian mentality might be more inclined towards a business owner/manager model while the GCC would accept an ownership or investment without the management aspect. Also it might be for the reason that HNWIs in the GCC are to larger extent more affluent than Egyptian HNWs, the GCC was found to be one of the highest regions with HNWs and Ultra HNWIs, 400,000 HNWI and 3,600 UHNWI in the region (Morales *et al*., 2011). Accordingly, they can afford to forego control of some of their excess wealth to be managed by PEs and VCs. An industry professional indicated:

"Banks and pension funds don't invest in VCs… so we're left with HNWI… In Saudi for instance they are all HNWI… so they can participate… they want to partner and don't want to manage…".

Figure (7.2): LP Mix in Middle Eastern PE



Source: Balze *et al*., (2010)

In the case of Egypt, another distinctive factor for VC fundraising was found to be developmental financial institutions (DFIs). An SME dedicated fund managed by one of the leading PE firms was majorly funded by the European Investment Bank (EIB). Moreover, in the first quarter of 2013 the American Egyptian Enterprise Fund was announced to finance start-ups and early stage ventures that was backed up by developmental agencies. The fund will launch with $60 million, and will add an additional $60 million over the next few months, in hopes of reaching $300 million in three years (Solayman, 2013). In addition, before the end of 2013 a fund of funds was announced to be established by the SFD fully financed by the World Bank. It was discussed that it will fund current VCs in Egypt. Furthermore a VC director indicated that a USAid programme is also being developed to match current VC funds in terms of funding and capital guarantee. This would explain the limited options for fundraising for VCs in Egypt as well as the realised positive economic effect and urgency to stimulate the VC industry in Egypt by DFI vehicles.

VC fundraising in Egypt could be one of the biggest challenges facing the Industry. From observations in the SMEs financing company, personal experience, and interviews, there was an evident lack of risk appetite among investors in addition to the high opportunity costs for other rewarding investment opportunities. In an SMEs financing company, investors highly realised the importance of VC activities, yet they opted to dedicate 5 to 10% of the capital for start-up early stage VC financing with the remaining capital distributed among franchising and supply value chains. This conservative appetite reflects a lack of confidence in VC profitability and success. Regarding opportunity costs, it was apparent that since the early 2000s, Egypt went through unique financial opportunities. Such opportunities ranged from real estate, to the unprecedented growth of stock market, and the privatisation opportunities that flourished PE activities. According to a PE/VC director, it was not possible to find VC opportunities that compared to the profits of PE. This was in 2008, where the company acquired a state owned enterprise (SOE) and managed to sell it at double the price in around 18 months. Moreover, an industry professional argued that the capital stock exchange market yielded 137% in 2004, 143% in 2005, 14% in 2006 and over 50% in 2007 and therefore chances are much higher that a VC will succeed in a downturn of the economic cycle as an alternative route for investors.

According to an Egyptian HNWI, the real estate is a safe haven and till 2009 he managed to double his gains in 2 to 3 years. The high gains that were present in Egypt till the year 2010 might have hampered the appetite for VC investments. It might have postponed recognising the industry as a potential viable investment option. This also reflects the opportunity based funds and a herd effect that occurs when such opportunities arises in less developed economies. After 2010, the privatisation activities seized, the capital market was performing below average, and real estate was in a noticeable slow down. As a result, VC might be able to prove itself as an alternative profitable source for investors. A plausible theoretical explanation would be resource dependency theory in this case. As Investment companies compete for resources (i.e. Funds) to be able to survive through management fees and gains, they would be more generalist and follow the appetite of investors more than their own strategy or focus.

"We don't have any venture capital fund, it just never happened... start-ups are not within the appetite of our investors... the realm of VC, angels, and development fund are not in our scope… we thought of a fund for infrastructure… we even started the setup... but we were faced by the financial crisis so we postponed it... it was because of a fund dedicated to the infrastructure for Mediterranean countries… so we were to manage a billion pounds…" (PE/VC director).

The absence of institutional long-term investors, and a high opportunity cost for HNWIs (the major source of VC funding), imposes serious challenges to VCs in Egypt. The option of DFIs, as earlier discussed, might recompense for the shortage of funding in the VC industry in Egypt.

7.3.4 Financial Markets and Regulatory Framework

From a financial markets perspective, Black and Gilson (1998) stressed on the vitality of a stock market centred economy over bank centred ones to accelerate the exit of VCs investments via IPOs. They believed that it is more important than the cultural differences and risk taking behaviour in order to develop a vigorous VC market. On the other hand, Jeng and Wells (2000), agreed on the importance of stock market vitality especially on fundraising activities to guarantee a dynamic investment cycle. However, they perceived government policies both by setting regulatory stage and by 'galvanizing' investments during downturns as a more important aspect to enhance a VC industry. They argued that IPOs are only more important for late stage investments than to VCs catering early-stage ventures and start-ups that are more affected by 'labour market rigidities'. Furthermore, Armour and Cumming (2006) argued that the legal environment matters as much as the vitality of stock markets. They added that liberal bankruptcy laws stimulate entrepreneurial demand for venture capital and that government programmes hinders PE more than it benefits it, concluding that legal reforms are vital for a VC industry to flourish.

The depth of capital market performance in Egypt was mostly found positive by PE/VC index (Groh *et al*., 2014). However, it was found to vary significantly among the sub indicators. It was noticeable that some of sub categories varied significantly along the years from 2009 till 2013. The size of the stock market decreased drastically in year 2011 after the political and economic instability after the January revolution; however the trading volume was not much affected. The index highly rated the debt and credit market (14 over 118 countries). Although the strength of banks was evident, yet its contribution to SMEs was found negligible (see section 6.2.1). Moreover, non-performing loans were one of the indicators that Egypt lagged behind most of world economies ranking 97th over 118. Even though some of those indicators might be descriptive, it was found through the primary gathered data that neither banks nor stock market was sufficiently supporting SMEs or VCs. On the other hand, PE firms were found to highly benefit from leveraged capabilities through banks and IPOs prior to the January revolution. Moreover, the NILEX was expected to act as both a financing and exit vehicle for SMEs and entrepreneurial ventures; however, it is still in a developing phase far from its potential objectives. It might be plausible to argue that the depth of capital markets was more favourable to PEs more than VCs in Egypt. This argument would be supported by Jeng and Wells (2000) findings, suggesting that depth of capital market would be more important to late stage (PE) than VC early stage activities.

Regarding the regulatory perspective, tax incentives and administrative burdens were found negative according to the index Egypt was ranked 83rd over 118 counties which is also the same rank regarding corruption and bribing. It was well noted that Egypt performed poorly on both World Governance Index (WGI) and Economic Freedom Index (EFI). According to the WGI, Egypt scored an overall 26.5% on the scale of 100% on the worldwide governance indicator. In addition the EFI indicates that the Egyptian Economy is mostly un-free scoring 54.8 out of the maximum 100 index. In the PE/VC index, labour market rigidities ranked Egypt 82nd, while ease of starting a business 47th. Regarding ease of closing a business Egypt was ranked 100th over the 118 countries. All previous indicators and earlier discussions on the regulatory pillar on entrepreneurial finance (see section 6.7.3) indicate that the regulatory framework is cumbersome and non-hospitable for a VC industry to develop in Egypt. VC/PE directors and industry professionals persevered that other MENA countries are improving their regulatory system to become highly welcoming for financial institutions and VC activities. This would create a competition among the region, noticing that they operate in the same markets, and VCs might opt to base their activities in those countries while operate regional. For example, Dubai in the UAE and Bahrain are among those countries who managed to create a highly favourable environment for financial institutions in general, PE and VC firms in specific. Institutional and sophisticated investors were expected to support on the regulatory changes by continuing the pressure on the regulators to implement crucial changes towards a hospitable regulatory framework in MENA region (Morales *et al*., 2011).

7.4 VC Micro-perspectives: Differences in Firms' Activities

This section analyses the findings on the VCs' activities and their firms' behaviour in Egypt and relate it to the international literature on micro-perspective country differences. Following a Gompers and Lerner (2001) explanation of the VC cycle will help in organising and illustrating the findings and relating to existing literature. First are the differentiating factors in 'fundraising', then 'investing', followed by 'monitoring and value-adding', and finally 'exiting'. Building on the literature on VC firms' behaviour in an international setting, it was found to cover the whole investment cycle and the major themes arising from it. First,

7.4.1 Fundraising Activities

Starting with fund establishment forms, as part of the fundraising activities, Megginson (2004) found the US fund setup different than that of Europe. He figured that the major differences are related to the structure and funding of their investment vehicles; US VC funds mainly take the form of independent limited partnerships while in Europe they tend to be investment companies divisions of larger financial institutions. Therefore, the sources of funds tend to differ, the US counts on pension funds while Europe considers banks as its primary source of funding (Ooghe *et al*., 1991; Megginson, 2004). In the case of Egypt, it was found that in PE/VC firms the main source of funding was HNWIs, while VCs tend to rely more on the personal wealth of the GPs. Due to the flexibility of HNWIs and personal funding, VCs and PEs tend to adopt an offshore fund policy to avoid cumbersome regulatory system in their home countries. Moreover, they chose complex combinations to legitimise their presence and activities in home country by establishing holding/investment companies and advisory firms to set an LP/GP model and SPVs for their investee firms to mirror their offshore activities.

"The world structure of LP/GP is not in the Egyptian law… and this is why we resort to offshore, we establish the GP offshore however we can establish the fund in Egypt and this what we did… we do this in the form of regular stock joint companies and according to the law it's permitted that I invest in other companies that work in the same field.. So mostly we adapt to the requirements of the fund [requirements] we work with…" (VC/PE Director).

According to another VC/PE director, they are structured as an Investment company according to law no. 8, and not as a fund. They increase the capital according to the opportunities and the appetite of investors. However, they still created a fund management company where all the payroll and employees are hired upon. They actually use the investment company the very exact way as a fund structure. Nevertheless, the option of British Virgin Islands (BVI) judiciary base was the most favoured among VCs and PEs. The primary reason for choosing such setups was to avoid capital gain taxes. An industry professional added that to overcome capital gain taxes issues one needs to create novel solutions.

"After all this time and until now we can't say the government understands what VC is and how it works… and that shows in how VCs work… they [VC funds] either establish a fund abroad or establish a company that invest in other companies... no one chooses the route of the VC… Anyone wants to establish a VC they'd set a BVI fund or other funds abroad even GCC started to compete in this part… or establish a regular [investment] company to get out of this story [issue]…" (Industry Professional).

Similar findings were discussed in the Booz & Co/INSEAD report on PE in MENA region. The regulatory sophistication varies across the MENA region; fund structure and target investor will affect the extent of regulation. It's typical to find BVI, Cayman etc. setups to be able to raise funds, as there's no differentiation with deposit taking meaning that fund management will often require a full banking licence (Morales *et al.*, 2011). *"It is worth noting that many of the ME states do not have a sophisticated regime which distinguishes between institutional investors and other investment professionals on one hand and less sophisticated investors on the other, meaning that no regulatory relaxations apply with respect to offering fund investments to institutions or high net worth individuals."* (Morales *et al.*, 201: p.15). The same applies to Egypt and it might be stricter than many of the GCC countries such as UAE and Bahrain. The onshore/offshore setup was preferred to enable VCs to freely receive capital and to avoid tax gains, in addition to allocate an LP/GP model which is not recognised in Egypt avoiding cumbersome regulations by the regulatory bodies.

Regarding other topics on fundraising, Barnes and Menzies (2005) identified in their study on European LPs-VCs relations that limited partners (LPs) used systematic investment decisions related to those used by VCs. They discovered that ‘ratification’ among other LPs, reputation and history gathered from entrepreneurs as well as early informal relations with VCs all affected their investment decisions. The LP-GP relationships are highly dependent on a small network of highly closed trust circles.

“There’s something called an investment club... I have a group of investors that I always deal with and those are what investments rotate around...” (VC/PE Director).

Reputation is paramount to do business in the MENA region, networks are never enough, and since many of the VC/PE firms are relatively new (as the whole industry is) they tend to rely on the reputation of an umbrella firm such as a large investment company or a reputable bank (Morales *et al*., 2011). Moreover, VC funds tend to rely on the reputation of the LPs themselves, who are mostly well renowned HNWIs, which strengthen the authority of LPs over VC fund managers (*op. cit.*). The VC fund's historic track record and team’s reputation along with local market experience were found to be a determining factor for LP investments all over the world (Groh and Liechtensien, 2011). However, in Egypt and MENA region, due to the lack of sufficient track records, reputation alone might be the main determinant for LPs choice.

Regarding compensation issues, Gompers and Lerner (1999) figured in their work on the US market that compensation is sensitive to performance in older VC firms. They argued that performance in new VCs is due to their keenness to build a good reputation regardless to their compensation schemes. Other factors governing the relation of LPs and general partners (GP) or VC firms are restrictions in the form of covenants such as prohibiting raising other new funds, limiting investment sectors, and funding firms earlier financed by the same VC from other funds (Gompers and Lerner, 2001). Those restrictions were found lenient when there is a high flow of capital to the VC industry. The influence of LPs was found high in Egypt and all over the MENA region. Due to the limited options for fundraising, HNWIs have a high bargaining power over GPs. This would be also transferred to the management fees and imposing certain covenants and agreements with the fund managers.

"We live on management fees and carries, it differs some funds the fees barely cover my salaries, barely... 2 + 20 is over now since the financial crisis... Now the investors involve in all expenses and they try to decrease it… there is some reshaping now"

(VC/PE Director).

7.4.2 Investment Activities

Second, are the investing activities, which include screening, due diligence, valuation and deal structuring. Gompers and Lerner (2001) identified four major aspects in VC investments in the US that helped them overcome information asymmetries. First is staging of finance over time, second is syndication among other VCs, third is a seat on board of directors, and fourth is a compensation arrangement in the form of stock options. Accordingly, differences among countries regarding those investment aspects and how in their own way do they overcome information asymmetries, might be shaped by institutional factors. Staged financing was found to be the norm in VC investments in Egypt; however syndication with other VCs was insignificant and hardly occurred among VCs.

Bruton and Ahlstrom (2003), figured that the VCs in China tends to fund firms closer to their region and rely on relations rather than accounting information because of weak regulatory institutions.

"Deal sourcing is done through many ways... one is through referrals with current investment banks and boutiques...we also go and screen ourselves and approach by ourselves... depending on the criteria of the fund... we have someone who is dedicated for this job… yet we all do that... me as a partner as well as the other partner 3/4 of our time we do business development... between business development and monitoring our investment.." (PE/VC Director).

It was found that some deal sourcing was through PR activities via seminars, word of mouth and referrals. However, contrary to larger PE/VC firms, most of the referrals in smaller VC firms were through a small circle of family and friends depending on their personal networks. Heavy reliance on networks was found to be a key aspect in most deal sourcing activities. Building trust among VCs and entrepreneurs was a critical determinant in deal sourcing. The weight of trust is an important factor in investment decisions in developing economies, trust is paramount in weak legal systems, and therefore it is important to be built in the VC-Entrepreneur relationship before deal selection (Bruton *et al*., 2005). According to a VC director trust issues are of great importance and one has to know the potential investee in a personal way to be able to decide to invest in his company. Moreover, a VC director added that they rely to a great extent on trust and long term relations with their investees and believe such qualities were an essential ingredient for protecting their investments. Trusted networks and relationships are of high importance in the MENA region, it might be due to lack of information and the family business nature of the region (Morales *et al.*, 2011).

"Trust is the base, it's the most important thing we do... we discuss this as the first thing….from our experiences the most important factor that makes an investment successful is the partner, it's not the performance or the market... if you get along with your partner and we understood each other well and we started to respond well it goes well... we have problems, ups and downs… you can do all agreements in the contract and still you can go bust… with other partners you can ignore all this and it flies.. It can apply on our investors too but it is not a personal thing it's more of comfort..." (PE/VC Director).

In a paper by Zacharakis, McMullen and Shepherd (2007), the influence of economic institutions on the VCs in US, Korea and China was tested. They figured that the US as a mature market economy relies more on market information than Korea and China and that China weight human capital more heavily than the US and Korea. Moreover, they argued that although professional institutions may dictate which information to include in VC decision making, the extent emphasised is partly determined by the economic institutions where VCs are located. The effects of legislative systems are obvious in many countries as well as the level of legal enforcement. Investments in low legal enforcement, civil law countries, depend on common stocks and debt while maintaining board control instead of contractual and convertible shares and covenants adopted by high legal enforcement, common law countries (Lerner and Schoar, 2005). They added that transactions in high law enforcement countries have higher valuations and returns as a result of the favourable regulatory environment. Thus in Egypt, as a country adopting civil law and with a low legal enforcement, it is not surprising to rely on human capital rather than market information and depend on common stock and maintain board control.

Regarding the required rate of return in VC investments, Manigart *et al*. (2002) studied this aspect across the US, UK, Netherlands, Belgium and France. They found that VCs who are more intensely involved in their investments, have a short holding period, and being located in the US and UK, compared to the Netherlands, Belgium and France, generally require higher rates of return due to institutional differences. They also figured that early stage VCs require higher returns if they invest in later stage ventures, which found consistent with resource based theory, on the other hand, buyout specialists require lower returns when investing in expansion companies, which found consistent with financial theory. Moreover, diversified VCs require higher returns than specialists, and independent VCs also require higher returns than captive or public VCs (Manigart *et al*., 2002). In the case of VC and PE firms Egypt, the expected IRR was found relatively high in the range of 25-30% annually and specifically in early stage VC firms it was an expected minimum multiple of 3 over 5 years. This was also the case with most VC/PE firms in the MENA region. According to MEPEA (2013) association's survey in 2012, 74% of fund managers are targeting an IRR over 20%.

Regarding contracting methods of PE/VC firms in MENA region, Eid and Romieh (2005) researched this area and found that some sections of the contracts were relevant to the environment of the origin of the contract, while other sections take the form of bilateral agreements. They added that the types of securities such as ordinary common shares vs. convertible preferred shares and the sizes of deals are more affected by the level of GNI per capita than by the origin of the local legal system. In Addition, many exit rights and other protective covenants were not indigenous to local legal systems have been used by PE firms which signals the transition of those covenants from developed VC markets. This was also the case in Egypt, some of the covenant agreements were made according to foreign judiciary systems. Preferred shares through SPV establishments as well as convertible Debt or Equity structures were evident. This goes in line with the findings of Eid and Romieh (2005), signaling the transition of VC covenants from developed VC markets.

In respect of the valuation dimension, a comparative exploratory study of the US, Hong Kong, India and Singapore by Lockett, Wright, Sapienza and Pruthi (2002), identified significant differences in the various sources of information for ventures valuation which are the use of business plan data, due diligence, sales and product information, and information related to entrepreneurs. They also found significant differences in the use of asset valuation, such as EBITDA, and option based evaluation methods. In addition, they identified that there are generally no significant differences in the common use of DCF and other widely used important valuation methods suggesting that evaluation science is easily transferred across countries while sources of information VCs can trust are more culturally determined. This is quite different than the findings in Europe, according to Manigart *et al*. (1997) there were differences in the widely used valuation techniques across European countries. They figured that UK mostly used multiplication of past or future earnings with price-earnings ratios while Netherlands and Belgium uses DCF and France mostly used net worth book values. In the case of Hungary, VCs are seeking venture control more often, they were also found less reliant on DCF (Karsai *et al*., 1997). On VC in

Estonia, Sander and Koomagi (2007) argued that Estonian private equity and venture capitalists to some extent use valuation methods differently than their use in Western European and American VCs, still they use multiples, discounted cash flow (DCF), and book-value techniques. They also found that human capital was the most important criteria. Anti-dilution issues were found not important, syndication was insignificant, while staged investments and minority holdings were in practice. Furthermore, there are also differences among the Asian countries which indicate heterogeneity in spite of system similarity (Lockett *et al*., 2002).

"We don't follow one valuation method... we use PE multiples EBITA multiples... they're important… we use DCF in growth cases where potential is in growth and not existing operations... These are mostly the two most frequent methods…" (PE/VC Director).

A VC director argued that the most important aspect is the entrepreneur and his idea, secondly comes the turnover of the company and cash flows. He continued, in start-ups and early stage it's almost impossible to follow a simple evaluation method, it's a matter of evaluating how much this company could be put up for acquisition when ready. Through his argument, it was noted that he related the success and potential of some of the investee companies by the number of subscribers and its Facebook page followers; indicating the importance of the number of users in valuating different technological ventures.

7.4.3 Value Adding Activities

Third is the research relevant to monitoring, governing, and value-adding practices. In the context of value-adding, Pruthi *et al*. (2003) figured that in the Indian market VCs tend to be more involved on operational level such as in introducing new customers, suppliers and marketing plans. In contrary to the findings of MacMillan *et al.* (1988) where VCs in US market are most involved in financial matters of new ventures and acting as a sounding board to their ventures, while least involved in the operations of their investee companies. Moreover, Gorman and Sahlman (1989) found that the most common activity for US VCs is to help raise additional funds followed by strategic analysis and management recruiting. In addition, Asian boards of VC backed firms were found larger than US boards with the largest percentage of insiders; the financier role was found more important in Europe and in bank centred economies than in capital markets; strategic and interpersonal roles were more important in US and in countries valuing entrepreneurship, whereas the networking role was to an extent more important in Asia than in the US and Europe (Bruton *et al*., 2005). Sapienza *et al*. (1996) showed that in US and UK VCs are more involved in their ventures and added more value than in France or Netherlands, while the activities were not different among the four countries. According to Farag, Hommel, Witt and Wright (2004), the CEE PE industry was distinctive in the risk factor that was apparent in their contractual and monitoring extensive practices. In the case of Asia, VC firms in China utilise proper connections and close monitoring regarding them as more reliable than complex contracts thus substituting regulatory controls (Bruton and Ahlstrom, 2003); similar to the case of Vietnam (Scheela and Van Dinh, 2004). Uniquely in Vietnam, networking with government officials was perceived a value-adding activity (Scheela and Van Dinh, 2004). Moreover, VC-CEO relationship in countries with higher dependency on social networks is not perceived in the agency context and is relatively stable (Bruton *et al*., 2005). Bruton *et al*. (2005) argued that it is not judged by time efficiency economic reason as in other countries of lower dependency on social networks hence spent twice as much time with their investees than their US counterparts. Worth to mention, value-adding activities in China in the form of advice must be handled diplomatically for 'face' issues which are highly respected in this part of the world (Bruton and Ahlstrom, 2003). In the case of Egypt, it was also found that networking, access to decision makers and growth partners were among the top activities of VCs. Acting as a financier was also important and could be as important as access to regional and international markets and larger corporations in developed VC markets such as Silicon Valley and hi-tech corporations. According to industry professionals, value can be created by adjusting organisational charts and applying corporate governance, proper financial restructuring and proper management. In addition, an industry professional argued that VCs biggest role is financing, other roles could be incubation, development, and support functions, allowing entrepreneurs to focus on their core activities. A VC director indicated that it was unfortunate that VCs' primary role in Egypt was financing. He added that entrepreneurs have no other alternative for financing, this leads to a high bargaining power for the limited number of VCs in Egypt. It is supposed to be the other way round, he argued; yet lack of alternatives still makes finance the primary reason to be approached by entrepreneurs.

"Entrepreneurs consider raising funds [from VCs] a success in itself... it's very competitive... they [entrepreneurs] might fail to see what VCs can really offer them... which VC best suits their needs... they should focus on the past experience of other entrepreneurs [with VC funding] and not be tempted with who puts in more cash" (VC director).

Regarding the late stage financing in the form of PE;

"Our team with our major investor would believe that our main value adding would be our philosophy on what we are going to do with this investment... it's not just money... we will bring people and adjust the company... enlarge... merge... a bigger spectrum of services and products.." (PE/VC Director).

Another PE/VC director added that the major value adding activities are strategic guidance, financial activities such as budgeting, cash flow, and expenditures, and exit options and evaluation methods upon such exits respectively. From a demand side, VC backed entrepreneurs were focusing on the synergies and connections of the VCs. Among their objectives were found to be building on existing ventures of the VCs portfolio companies for integration and team synergies. Finance was evidently the main reason for IT based ventures to seek VC funding before considering value adding activities. It was explained by the apparent lack of alternatives in Egypt.

Regarding investment strategies, most of the firms were found to be generalists. Some funds were specialists yet an overall generalist approach was most dominant. Early stage VCs were inclined towards 'technology enabled' or 'technology driven' ventures, however they still consider other non-technology based ventures. Thus they remain generalists in their broader strategies. Board representation was a must and close monitoring was the most prevailing. Moreover, early-stage VCs had a considerable number of entrepreneurs as in house tenants within their premises, although it was optional. On the other hand, some VCs tend to have a regional reach to explore further opportunities in different countries. For example one VC firm's main strategy was being generalist. They started as an IT Industry specific and then shifted by time to more consumer businesses. They invest anywhere between 1 to 10 million L.E (900,000 to 9 million GBP) per transaction and they have a very hands-on approach towards their portfolio companies. Another VC director indicated:

"Typically, we invest $250K - $1M initially and expect to invest $2M to $5M over the life of a company".

In early stage VC activities, a minority stake was the norm yet varied significantly to be anywhere between 15-30%.

Many PE/VC companies were getting quite larger as they seek opportunities beyond Egypt, in MENA region, and the Mediterranean including Turkey as an example. However their major concern was to avoid countries with political or economic instability. This was also evident with early-stage VCs; they were actively seeking expansion in the more stable GCC countries as well as Jordan and Turkey. A regional expansion was notably high in the late stages of the research after the increasing economic and political challenges in Egypt.

7.4.4 Exit Strategies

Finally is the topic on exit strategies and harvesting, which is the fourth and last part of the VCs cycle before renewing themselves with another round of fundraising. According to Gompers and Lerner (2001), the highest return on exits is realised via IPOs in the US market and other developed VC markets. They also discussed issues such as pricing of VC backed firms in IPOs and timing to go public concerning the US VC industry. They figured that under-pricing occurs less in VC backed firms and that timing is usually in the peak of the market, they explained that this relies on the experience of VCs which otherwise causes ‘grandstanding’ (the pressures to be able to raise new funds compel new VCs to liquidate their ventures and thus exit quickly and prematurely). They added that a ‘lockup’ period of VC shares takes place to avoid negative signalling. In emerging economies, a second tier market can be helpful for smaller firms to exit; however, the VCs in developing countries have very little experience with taking their ventures through IPOs adding to the point that some countries as Singapore are not willing to liquidate their investments completely (Wright *et al*., 2005b). In CEE markets, lack of viable exits, other than trade sales, was found hindering the PE industry (Farag *et al.*, 2004). East Asian counties such as China have limited IPO exit practices and rely more on trade sales (Bruton and Ahlstrom, 2003). According to Wright *et al*. (2005b), the trade sales option is the most common in emerging markets; still they are slowed down by minority and majority stakes regulations and the right to sell to foreigners. It was evident in Egypt that the most common exit strategy is trade sales which in fact corresponds with the findings of Wright *et al*. (2005b), and Bruton and Ahlstrom (2003) regarding developing countries. It was also found that exit was the most challenging aspect among the VCs investment cycles. Moreover, the current political and economic challenges that are facing the business environment added to the pressures of profitable exits. Early stage ventures were found with the only option of trade sales. Furthermore, technology ventures were targeting ‘acqui-hiring’. ‘Acqui-hire’ is a term used by entrepreneurs meaning acquisition and hiring of the entrepreneurial team by the acquiring companies. During interviews, entrepreneurs referred to success stories of acquisition and hiring by major international technology players and looked highly for such success stories. Thus VCs with connections to Silicon Valley and major technology firms was highly sought after by entrepreneurs and was considered a huge asset to VC firms.

Regarding the public markets, during the years of 2011 till 2013 there was not a single IPO in the Cairo and Alexandria Stock exchange (CASE), in addition to the slow pace of the NILEX. According to a PE/VC director, exit strategies were found very challenging as well, especially that the NILEX is almost at a complete halt. An industry professional indicated:

“I would consider the biggest problem as exit… if I don't know how I'd exit why I would enter... and this is the primary problem... as for regulations there are surely many things missing here… SHA… rights... agreements... opportunities are there, many have ideas and looking for investors... investors hold back because they don't know how'd they exit… the exit notion is still not there… this will create a market for other investors who are willing to enter in this secondary phase... if NILEX was stimulated it will be a good chance for exiting… but you'll face the problem of evaluation... the company will be evaluated on its current performance and not future projections… also there is a lockup period for I think a year or so… they can overcome that since only the establishing shareholder who can't sell but a regular shareholder..”.

This was also evident in the report by Morales *et al.* (2011; p. 14): *"There are three broad categories of exit which are available: IPOs, trade sales and secondary buyouts or refinancing. To date, the ME region has seen a prevalence of trade sales, in part because regional IPOs have tended to be of large state enterprises. This reflects both the emerging nature of those markets and the legislation around IPOs, which tends to envisage large flotations by public subscription and consequently reduces the availability of IPOs as a possible exit route."*

A different approach emerged through the course of the interviews. Industry professionals suggested that diminishing partnership, which is *Shari'a* compliant, could be an alternative exiting vehicle for the region in the absence of the current IPO opportunities and economic challenges. The concept of the Diminishing Partnership (DP) is further elaborated on section (7.6) regarding VC and Islamic finance. Thus lack of exit alternatives could be argued a major alarming hurdle facing VC development. Novel and unconventional exit tools should be explored to overcome this major obstacle.

7.5 Institutional Analysis on VC Industry in Egypt

From an institutional perspective, Bruton, Fried and Manigart (2005); and Bruton, Ahlstrom and Yeh (2002), showed how VC industries were different across countries due to the differences in institutional forces in each country or region. Ahlstrom and Bruton (2006) studied the effect of informal institutions in emerging economies as formal institutions become more established, they drew attention to the impact of networks and changing institutional environments on VC industries in different phases of economic transition in emerging economies. On analysing VC in Singapore, Bruton, Ahlstrom and Singh (2002) found that the regulatory environment created by the government and its agencies helped explaining the differences between the VC in Singapore and Asia, they also highlighted the importance of cognitive (cultural) institutions and its impact on the Singaporean industry and how foreign VC adapted to local culture; similarly, in the case of India (Wright *et al*., 2002). Also, different environments imply different interventions to assist the emergence of a successful VC industry as concluded from the Indian VC experience (Dossani and Kenney, 2002). In the MENA region, Eid (2006) argued that lack of 'institutional complementarities' among the triad of finance, regulations and education is what is hindering the potential of the PE industry to act as a 'growth engine' to the region. She highlighted the availability of human capital in the region in the form of fresh graduate potential entrepreneurs willing to take risk and eager to establish themselves, in addition to the underutilized successful professionals who succeeded around the world and are willing to come back home and assist in the development of their home economies.

Regarding the level of institutionalisation, Bruton, Fried and Manigart (2005) explored the different levels among VC industries in the regions of the US and UK, Europe, and Asia. They argued that in emerging economies less formal institutions substitute for formal ones, which creates opportunities and obstacles for VCs operating in them. In their exploratory study, they grouped the US and UK markets as they share more similarities than that of the UK and continental Europe. They pointed that both countries share a common law legal system and are both capital market centred. Regarding entrepreneurship, they identified ‘status of entrepreneurs’ as willingness to take risk attitude among different countries. The findings of their research is summarised in table (7.1). The normative dimension in Asia was found to have strong normative values from the US due to training and interconnections.

It should be well noted that institutional determinants affecting entrepreneurial finance discussed in chapter six would indeed affect the VC industry in Egypt. However, in this section and the section on micro-perspectives were for the most part concerned to elaborate on VC specific institutional determinants.

Table (7.1): The Institutionalisation of Venture capital

	Normative	Regulatory	Cognitive
U.S. and U.K.	*Strong normative values in industry	*Mature *Common law provides high shareholder protection *Strong public equity markets	*Status of entrepreneurs is high *Reliance on social networks relatively weak
Continental Europe	*Industry developed from U.S. Strong normative values from U.S. due to its origin, training and interconnections in the industry	*Mature *Civil law provides lower shareholder protection *Bank-centered financial markets	*Status of entrepreneurs is lower than in the U.S. but higher than in Asia *Reliance on social networks stronger than in U.S. but weaker than in Asia
Asia	*Industry developed from U.S. Strong normative values from U.S. due to training and interconnections in the industry	*Generally poorly developed *Often do not enforce laws/regulations	*Status of entrepreneurs is low *Reliance on social networks stronger than in U.S. or Europe

Source: (Bruton *et al*., 2005)

7.5.1 Normative Forces

Regarding the MENA region in general and Egypt in particular, the normative pillar would be expected to be similar to the Asian market. The influence of the US would be present due to US trained VC practitioners and LPs who would have already invested in VC funds in the US. Moreover, many of the VCs in the region and Egypt tends to resort to larger technology funds as a trade sale exit strategy and therefore they 'mimic' their investment behaviour and follow the norms of the industry. The Silicon Valley model remains the magnet were VCs and entrepreneurs aspire.

The VC industry in Egypt would be considered un-institutionalised. It is a new concept with few players in the whole region as well as Egypt and had only recently started to emerge and become of significance. On the other hand, the PE industry would be relatively institutionalised. There are established PE associations in the region as well as an Egyptian Private Equity Association (EPEA) formed in 2010. Egypt has a handful of key PE players in the region and was the main recipient of all PE activities in MENA region till the January revolution. In contrary, VC in Egypt has no association, although EPEA partly covers VC activities, a designated VC association was found to be an important missing component to the VC industry (Seoudi, 2012). Policy makers indicated that supporting industries such as business and legal consultants and accounting firms are well represented and proficient in Egypt; however, lack of skilled VC fund managers and absence of an association for VCs in Egypt is a considerable obstacle.

7.5.2 Cognitive Forces

From a cognitive/cultural perspective, although the status of entrepreneurs was found high in Egypt (Hattab, 2008), the legitimacy of entrepreneurship and ‘uncertainty avoidance’ (see discussion Section 6.7.2.1) would arguably act as a burden towards a vibrant VC industry in Egypt. Regarding acceptance of failure, it is suggested that offence in collectivist societies leads to shame and loss of face (Hofstede, 2001). This factor was found to be significant in VC industry reports on the MENA region: *“One of the prevailing cultural and legal problems with setting up a start-up business in the region is the non-acceptance of failure. While many cultures embrace failure as an invaluable learning experience, the Middle East is less comfortable with the topic. The fear of embarrassment, shame, loss of face, and potentially imprisonment discourages much young potential from becoming entrepreneurs. The cultural ramification of failure could be substantial to the individual and his or her family. The region’s legal systems are also not build to deal* *with bankruptcy and liquidations, and company founders could be subject to major legal litigation if their companies are not able to pay their dues in troubled times"* (Boigner: MEPEA, 2013: p.4). It also shows that the regulatory system is reinforcing the negative implications of failure.

The current political instability is once more negatively affecting the entrepreneurial activities in Egypt; right after the revolution the 'spirited', 'hopeful' environment' was in favour of entrepreneurial growth (El Dahshan, 2014). According to Hattab: *"Egyptians, immediately after the 2011 revolution, displayed striking interest in starting their own companies and breaking from traditional mould."* (El Dahshan, 2014). Regarding innovative opportunities and idea generation, Egypt witnessed a big leap in entrepreneurial activities since then. Moreover, new relatively cheaper technologies such as, social networks, smart phones and mobile applications appeared to be alternative, affordable yet innovative opportunities to entrepreneurs. As earlier discussed in the previous chapter (section 6.7.2.5), 'technology enabled' ventures are attempting to substitute the lack of breakthrough innovative technologies which needs high R&D and large investments with a simpler model to create value and differentiation.

Heavy reliance on informal social networks would be stronger than the US, Europe, and possibly Asia. The dynamics of networks on entrepreneurial finance was elaborated in the previous chapter six (section 6.7.1.5). Furthermore, cultural acceptance discussed in the previous chapter for equity financing and primarily VC model was partly explained by cooperative nature of the society in the form of informal networks (section 6.7.1.5) and Islamic influence (section 6.7.3.2). This cultural dimension might be considered the strongest pillar in favour of growth of a PE/VC industry and especially start-up, early stage VC. Such social and cultural factors that are specific to Egypt as part of the MENA region should be well taken into account as a contributor to the distinctive normative and cultural influences on the VC industry in Egypt. Accordingly, further discussion on the specific influence of Islam on venture capital emerged to be fundamental for this research. Section (7.7) investigated further explanations on the topic of Islamic influence on VC industry in Egypt.

Li and Zahra (2012) suggest that the more developed a nation's formal institutions the more likely to reduce transaction problems and encourage VC funding. They further suggests that formal and informal institutions, specifically cultural institutional forces, are intertwined and therefore even similar formal institutions in different nations may result in a different development of its VC industry. According to Valdez and Richardson (2013), normative cognitive power was found more descriptive on macro-level entrepreneurship than the regulatory and legislative power. Thus it is suggested that understanding the normative and cultural determinants are eminent in addressing macro-level entrepreneurship in general and VC in particular.

7.5.3 Regulatory Forces

From a regulatory perspective, the MENA including Egypt would be poorly developed, low shareholder protection, low enforcement of law, and low financial markets development. Egypt might be an exception for it has a well-developed financial market 'infrastructure' that has the potential of further enhancement. The regulatory framework is neither in favour of PE firms nor VCs, however, till present both activities although mostly unregulated by the government they are tolerated to a great extent. It is partly because of the accommodating complex legal set-ups of those firms and due to their recognizable benefit to the Egyptian economy.

The urgency of improving and developing a favourable regulatory framework was a consensus among all interviewees and industry reports on Egypt and the region. It could indeed be the major hurdle for creating a healthy and significant VC industry. The political and economic instability is highly affecting the prioritisation of this aspect to the Egyptian government. Kept in mind, the regulatory pillar might be the gate for foreign and regional VCs to explore the entrepreneurial activities and increasing opportunities that are taking place among the Egyptian youth.

"Currently the number one challenge is the weak macro-economic performance affected by the political instability, then lack of regulation mechanism by the government… not only a law, but the implementation as well…there is no preferential tax treatment for VC companies in Egypt, requirements set by EFSA, including the minimum fund size, and investment portfolio shares, are stringent..." (Policy Maker).

The findings are in line with the work of Armour and Cumming (2006); suggesting that regulatory framework might be as important as depth of capital markets. Moreover, the cumbersome bankruptcy laws in Egypt may stand as a major hurdle for the development of a VC industry (section 6.7.3.2 for discussions on bankruptcy). Armour and Cumming (2006) highlighted the importance of the regulatory framework to support VC industries; bankruptcy laws were found a primary determinant in such regulations. Under the current regulatory framework in Egypt, it is very unlikely the VC industry can flourish and have a significant role to the economy. The capital gain tax would be would be a major hurdle towards a favourable VC regulatory frame work. According to Gompers *et al*. (1998), reduction of capital gain tax can encourage supply to VC funds. In Egypt capital gain taxes were considered high by industry professionals (20%) and there were no preferential rates for VC activities. Thus it would be considered as another regulatory hurdle.

Similar findings were further recognized in studying developing and emerging countries' PE and VC industries. In Latin America, namely Argentina, Pereiro (2001) examined entrepreneurial finance and VC in Argentina to find that the average investment size per start-up is larger than in the US and that the business law is still problematic. However, he argued that the government played a significant role in the awareness of the VC industry among entrepreneurs. Another example of Latin America is the industry of Brazil. It has been analysed in a comparative study by Mariz and Savola (2005) on PE and VC industries in Brazil compared to the US figured that enhancing corporate governance, improving shareholders' minority rights and encouraging pension funds' investments have all facilitated the growth of the PE industry, however, unfavourable tax systems, high nominal and real interest rates are the major threats to the industry's development. In addition, the industry lacks seed capital and illiquid capital markets which are considered as major obstacles. Other researchers have examined the VC industry in transitional economies such as the work by Klonowski (2005) examining the evolution of the VC industry in Poland and its distinct stages and features. In addition, Karsai, Wright, Dudzinski and Morovic (1998) on VC industry in Hungary, Poland and Slovakia compared to that of the UK noted that the legal systems in different countries affect the VC firms and that specific legislations impedes the development of VC firms in the three Central and East European (CEE) countries. Also there is the work by Chu and Hisrich (2001) on the important role by the government promoting VC in Hong Kong as a promising Asian technology hub. It is apparent that developing economies share many problems regarding business environments and its effect on the development of a VC/PE industry. However it remains that the severity and priority of such problems and its roots stem from different causalities from one region to another and from one country to another.

Table (7.2) summarises the institutional forces; normative, cognitive and regulatory pillars highlighting both the conducive and obstructive factors.

Table (7.2): Institutional Forces Affecting VC Industry in Egypt

	Normative forces	***Cultural-Cognitive Forces***	***Regulatory Forces***
Obstructive Factors	1- Lack of a VC association.	1- Low levels of innovation.	1-Unsupportive bankruptcy laws toward entrepreneurship.
	2- Lack of VC industry specialists. .	2- Lack of sufficient education.	2- No capital gain preference.
			3- No incentives or reward for risk investors.
			4- Insufficient R&D support.
Conducive Forces	1- Positive perception towards entrepreneurship.	1- Islamic finance influence supporting risk taking and equity financial tools.	1- Efforts on restructuring and development of the financial sector.
	2- Viability of informal networks compensating lack of formal.	2- Charitable practices induced by Islamic and cultural behaviour.	2- Relative depth of capital markets..

7.6 Venture Capital and *Shari'a* Compliance

The impact of Islam as an institution throughout the economic history of the MENA region is well established and has a significant influence on shaping its economy (Kuran, 2004).The Islamic finance industry holds over 1.3 Trillion USD of assets (Mughal: Zawya, 2013). There are approximately 1 billion Muslims around the world, yet Islamic finance is concentrated around the GCC in MENA, Malaysia and Indonesia in South East Asia (SEA), and the United Kingdom (UK) in Europe (Farid, 2012). The UK has created access for Islamic finance to enter Europe through its British banks and joint ventures in the Arab world (Wilson, 2007). In the world, there are currently over 2000 Islamic financial institutions with activities ranging from Islamic banking, Islamic insurance (Takaful), Islamic funds, *mudarbah*, Islamic bonds (*sukuk*), and Islamic micro-finance (Mughal: Zawya, 2013). Islamic Funds grew to 58 billion USD in 2010 with a 7.6% growth with *sukuk* reaching 50 billion USD in issuance; Total Islamic funds is in excess of 500 billion USD with an annual growth of 10-15%, the GCC liquid wealth with *Shari'a* sensitive investors will add 70 billion USD by 2013 (Nazim, 2011). The size of Islamic banking in Egypt had grown by 6% from 2012 to 2013; it reached a volume of 114 billion by the end of 2013 representing 7% of the total banking sector in Egypt (Egyptian Islamic Finance Association: El-Ahram, 2014).

Literature has evolved around the topic of Islamic venture capital. Choudhuri (2001) had examined the Islamic venture capital instruments of *mudarbah* and *musharkah*. Choudhuri defined *mudarbah* as a profit sharing agreement between suppliers of capital and labour, management, or expertise while *musharkah* as equity participation where all are suppliers of capital in a joint venture. The main difference between *musharkah* and *mudarbah* is that in *musharkah* partners contribute with both capital and effort and they both shore profits and losses, while in *mudarbah*, one of the partners contribute with capital while the other with effort and only the capital partner loses his money with no financial losses on the effort partner (Farid, 2012).

The concept of Equity financing is not an Islamic concept, however it is *Shari'a* compliant (Wilson, 2007) and therefore permissible according to the Quran and *Hadiths* (Prophet's wordings and guidance) that forbids debt with interest or usury "*Riba*". Debt interest is unwanted and unethical according to Islam, however, *mudarbah* and *musharkah* (M&M) agreements are supposed to hold instead. Investors in VC funds and the fund management firm resemble here the *mudarbah* in the sense that investors are the silent owners of the capital and fund managers are the workers. On another level, the relation between the VC fund and the portfolio companies resembles the *musharkah* concept as both the VC fund and the entrepreneur are partners in the new venture. The two concepts combined legitimise the VC industry as being *Shari'a* compliant and thus favours its success over debt financing from an Islamic perspective as the dominant religion in the MENA region.

According to Hassan, Mikail, and Arifin (2011), the application of venture capital is neglected in the Muslim world while steadily developing in Western communities. They added that Islamic banks are also turning a 'blind eye' to venture capital despite the essence of profit and loss sharing. Since 2003, PE firms in the MENA region had developed *Shari'a* compliant funds to capitalise on the demand of such Islamic financial products (Wilson, 2007). Until the 1990s there were only Islamic banking, project finance and Islamic asset management; by 2005 more Islamic products were introduced such as Islamic leasing (*Ijarah*), Islamic bonds (*sukuk*), and later in 2010 liquidity management products were introduced (Farid, 2012). It was estimated that *Shari'a* compliant PE would've reached 41 billion USD in the GCC by 2011, however VC would still be much smaller and relatively unattractive. In respect to micro-finance, 800 million USD were dedicated to microfinance serving 1.3 million beneficiaries as of July 2013 (Mughal: Zawya, 2013). The development of SMEs can be an opportunity for developing *Shari'a* compliant VC and PE funds (Farid, 2012). Regarding *Shari'a* law and PE/VC activities, it is mostly based on a classic *musharkah* model which is a classic partnership agreement. The investors partner with the fund managers and they both partner in the investee firms. Other sub-models were diminishing *musharkah* (partnership) and temporary *musharkah* (partnership). Those two models mostly serve as a special purpose vehicle (SPV) for exiting scenarios in the case of diminishing partnership and a short term financing tool in the temporary partnership mostly to supply working capital.

The fitness of diminishing partnership as an exit alternative for VCs in Egypt has been indicated by industry professionals.

"*A diminishing partnership could be the best model in the absence of exit markets… it is applicable to Egypt however whether applied or not we need to know that… I'd expect this could be the best model… I've heard of it like a year and a half ago… so we can't judge if it happened or not…*" (Industry Professional).

The '*Musharakah-Mutanakisa'* or Diminishing Partnership (DP), as the name indicates, is based on '*Musharkah'* partnership where one or more partners buys the shares of other partners and thus leading to full ownership in an interest-free transaction, hence *Shari'a* compliant. DP was argued to be successfully applied in housing finance instead of mortgage for Islamic communities; the model is based on the highly successful Islamic Cooperative Housing Corporation introduced in

Toronto, Canada, established in 1981 for the Muslim community (Ramyah and Abdul Razak, 2008).

Musharkah is solely based on sharing profits and losses; it can take place in the form of management and/or ownership; capital could be in the form of liquid assets, commodities, or land (Farid, 2012). The notion of limited liability is also recognised in the Shari'a as the business is separated from the individual and losses do not transfer to the personal belonging of the business partners (Farid, 2012).

Besides an interest free financing, other criteria has to be met by PE/VC funds to be *Shari'a* compliant. Such funds should not participate or invest in projects that manufacture non-*halal* products such as pork products or alcoholic beverages, conventional insurance, entertainment activities that are non-*Shari'a* compliant, manufacture or sale of tobacco, share trading in non-*Shari'a* compliant securities, hotels and resorts, gambling or gaming, any other activity that a *Shari'a* adviser finds non-permissible (Wouters, 2008). Other requirements concerning financial ratios are as follows: total debt (divided by 12 months average market capitalisation), total interest-bearing securities and cash (divided by 12 month average market capitalisation), and account receivables (account receivables divided by total assets) should all be less or equal to 33% otherwise it will not be *Shari'a* compliant (Wouters, 2008). Preferred shares convertible preferred shares, and redeemable preference shares, which are essential in many VC covenants, were *Shari'a* compliant. It was indicated that non-cumulative preference shares are a form of *tanazul* (surrendering the rights) to a share of profit based on partnership. Leveraged buyouts (LBO) when used through Islamic bonds (*Sukuk*) are also Shari'a permissible (Farid, 2012). Regarding partnership and contract, as all religions Islam stressed on the values of business ethics, sources of *Shari'a* emphasised on respecting contracts, trustworthiness, and fighting fraud (Rizk, 2008). *"On the Day of Judgement, the honest Muslim merchant will stand side by side with the martyrs"* (Prophet Muhammad (PBUH)). In another *Hadith*, Prophet Muhammad (PBUH) has said that Allah (SWT) proclaims: *"I am one third partner of a two man partnership until one of the acts dishonestly to his partner, and in such event, I then leave them"*.

The model of the venture capital industry is not only *Shari'a* compliant but also reflects the essence of Islamic finance. Within a few *Shari'a* parameters the VC industry is entitled to receive funding from *Shari'a* compliant funds and can benefit from the immense growth of capital dedicated to Islamic finance. Moreover, the charitable nature of Islam can also help in the financial gap for MSMEs in the MENA region. It was found in this research that the GCC are more influenced by Islamic finance and give it more attention than other MENA countries. In Egypt, entrepreneurs were found to be more cautious and aware on the *Shari'a* compliance of VC than PE/VC fund managers. Industry professionals such as financial consultants and investment bankers also recognised *Shari'a* compliance as an important factor than VC/PE directors. It was found to be more of an individual preference rather than a societal norm.

According to PE/VC director:

"We can make a leveraged acquisition which is not Shari'a compliant… I dealt with funds and companies that use their own sharia compliance… I noticed that they only change the term and the structure was almost the same with very minor changes in the contracts and agreements… others they really apply Shari'a by the book... murabha and musharka....".

VCs and PEs were highly pragmatic; they were found likely to manage Islamic funds as any other commercial funds. However, as HNWI from GCC are the major component of LPs, those who are *Shari'a* cautious might impose some pressures to comply with *Shari'a* laws.

> *"It would sure be a plus for a large number of people if you do have a sharia compliant product… sure… In our company we won't mind leverage... I can go for it… but if my partner refused we won't do it… personally I do invest in hotels which serves alcohol and even have a gambling hall, so I don't have a restriction here… our retail fund prohibited from investing in F&B that serves alcohol… so it depends on the fund because we had two Saudi groups, not all Saudis do, of a majority strictly requesting not to get involved with alcohol.."* (PE/VC Director).

Another VC/PE director argued that it is more of a marketing tool to some of the funds that are *Shari'a* compliant. He added that other than that it has no real impact regarding preference for both the investors and the investee companies. He continued to argue that it might even has some negative limitations for investee companies to borrow from Islamic banks which are most of the times more complicated and more expensive. It was noticeable that preference for Islamic tools differed according to the personal ideologies and beliefs, which was found to vary across the society. The most common answer was VC being Shari'a compliant would sure add value and will be well received by many entrepreneurs. An industry processional indicated:

> *"I think yes sure… the Islamic part is of an impact, until now in Egypt we tend to do the things as God indicates".*

Moreover another industry professional argued that he didn't think people in Egypt are very much aware of the *Shari'a* compliance issues; however it sure would add a lot of value if it is well positioned within the framework of the business. The preference of equity financing over debt financing for some entrepreneurs might be against conventional wisdom. Pecking order of financing indicates that the cheapest source of financing is through debt and therefore it should be the first choice for entrepreneurs. It could be argued that cultural values and personal beliefs might act against the best financial rewarding method. Behavioural finance could be a plausible discipline for further understanding of this matter.

7.7 VC Policy Recommendations for Venture Capital in Egypt

There had been efforts by the Egyptian government to promote awareness to enhance the VC industry, yet still hadn't pay off (OECD, 2010b). Several initiatives were apparent starting from 2004. A report on the application of VC within SME sector was published in 2004 (MoF, 2004). Furthermore, a study on simplifying the laws and regulations governing SMEs establishment activities, growth, export, and dissolving was published in September 2005 (MoF, 2005). Roundtables between the ministry of Finance and international development agencies took place in 2006; they were followed by several workshops, seminars and events on the same topic. Among the recommendations of this work were to improve the legal and regulatory environment, in addition to, provide better training and improve the quality of human capital in the industry. Other recommendations included nurturing a VC association; ensure a communication channel among VC/PE firms and between them and entrepreneurs, recommend potential changes in tax laws as an incentive for R&D and investment, consider SME incubators, set numeric goals for the coming five years regarding investment deals number of companies funded and finally work with Cairo and Alexandria Stock Exchange (CASE) to pilot list in the new secondary market. Yet little is known on what had been implemented due to the closure of the SME unit of the MoF in 2010 and the political and economic challenges following the January 2011 uprisings. However, through interviews with policy makers it was clear that there was no follow-up on VC industry enhancement due to the pace of change among governments and ministers, and over and above that, the priority of more challenging and urgent matters affecting the economy, such as riots and demonstrations as well as the increasing budget deficit and escalating internal and external debt among other challenges.

International development agencies conducted research reports seeing the opportunities of a VC industry in the MENA region including Egypt. OECD (2006) report on risk capital in MENA region suggested recommendations for the industry's growth; they are as follows: encourage VC investments in family owned enterprises (FOE). Facilitate listing overseas, encourage corporate and individual investors to substitute institutional investors through tax or other incentives Encourage business incubators to foster innovation. Create technology clusters through universities and enterprises. Improve regulatory environments through taxation policies, intellectual property and commercial legislation improvement. Encourage foreign VC firms by improving FDI environment. And finally, close the financial gap in the different stages of ventures.The report concluded that although risk capital in the region is highly important to innovative industries; nevertheless it can also play a significant role in the financing of enterprises in traditional sectors.

Building on previous reports, academic literature, and primary data gathered in this research. The following policy recommendations are suggested to enhance the

VC industry in Egypt. In addition, it should be well noted that the urgency of developing a VC industry in Egypt could yield a short term benefit on decreasing unemployment and promote innovation needed for HGEs and their long-term benefit on economic growth.

1- Enhance entrepreneurial activities and idea generation among the society through government supported national competitions while promoting risk appetite among entrepreneurs. Awareness of VC investment and other financial tools should be taken into consideration. Furthermore, including women entrepreneurs could help decrease the apparent gender gap in Egypt. Highly rewarding entrepreneurs and media championing of successful models are much needed for the success of this model. Presently, this role is handled by NGOs and business associations with limited resources and reach-ability. Thus a national program is much needed for larger exposure and impact.

2- Differentiating between HGEs and other entrepreneurial ventures should be well identified and addressed. According to an industry professional:

"The development of the [VC] sector should coincide with the overall objective of the country... which is not clear due to the circumstances... So, first there has to be a consensus around what direction or priority the government needs to adopt... is it growth... is it employment... is it poverty reduction? or is it a blend of all. Whatever the vision, the VC will only flourish if it is attached to a clear overall objective... that is adopted in the true sense of directing resources to achieve it, and not just a statement...".

HGEs should be well supported as a primary target for VC investments. Realizing investment opportunities yielding high returns in different sectors and not necessarily IT sector should be well addressed in policy making and resources allocation.

3- To stimulate supply of VC funds, the Egyptian Government should allow pension funds to invest in VC activities. Furthermore, create incentives for banks to invest in VC funds. On the individuals' level, incentives for angel activities and HNWIs investing in VC funds to reward risk taking in the form of tax cuts should be applied. A regulatory adjustment to differentiate between professional investors to be able to supply VC funds is highly needed to relax the prohibition on receiving funds from the public.

4- To enhance the capital markets, Egyptian Government should facilitate access to NILEX listing. This could be achieved by applying relaxed and favorable conditions for SME listing. Further programs to share the cost of listing could support in increasing the numbers of SME listing. A secondary market would highly support the enhancement of a VC industry.

5- Among the major impediments found was the business environment caused by the unfavorable regulatory framework. GoE has to improve the legal environment by higher law enforcement, capital gain incentives, minority shares rights, IP rights, favorable bankruptcy laws, and tackling corruption. Furthermore, separately accommodate VC activities in a new law targeting favorable capital gain tax and lenient fundraising activities. Introduce a crowdfunding law to support the entrepreneurial funding gap and create an integrated eco-system.

6- Give political support and VC awareness by promoting a fund of funds for VC investments. This fund will act as a 'certification' and will provide 'legitimacy' for the VC industry by the government. Successful models of Israeli 'Yozma' fund targeting foreign VC firms and 'New Zealand Seed Investment Fund' encouraging locally based early-stage funds could act as guidelines for successful government initiatives enhancing VC industries (Lerner, 2009).

7- Create technology based clusters and capitalize on technology enabled new ventures; through possibly an entrepreneurship city with favorable taxes in certain areas. Another initiative should include a national business incubators/accelerators program focusing on 'value chain' and other indigenous industry-specific incubators. Furthermore, support the private accelerators through tax incentives and a favorable legal framework. According to Lerner (2009), there could be more innovation when there is more venture capital, not because the venture capital caused the innovation, but rather because venture capitalists reacted to a technological shock that was sure to lead to more innovation (p.61). Thus creating a technology base could indeed attract VC investors whether locally or internationally.

8- Regarding training of VC industry professional, Egyptian Government should introduce training programs for VC specialists and certification via EFSA. It should support building a VC association to spread favorable norms and ethics among the industry. It would also create awareness and assist in the supply of VC professionals.

9- Education was found to be a major hurdle towards entrepreneurship, entrepreneurial finance, and VC industry. To Enhance R&D in universities there should be an improvement in the research environment. An adequate rewarding system should be introduced, and create integration among R&D fund and research centers in universities. Furthermore the education system should introduce entrepreneurship education syllabus from early stage and among non-business schools, especially science majors.

10- Accommodate and ‘factor in’ cultural dimension such as *Shari’a* compliance and cooperative nature. The conducive normative and cultural factors of the Egyptian society should be taken into consideration in all policy recommendations. Moreover, building on the growing Islamic finance industry might be of support in the promotion of the fund of funds as well as encouraging individual investors to supply funding to the industry. The cooperative nature would also support stimulating fundraising if managed to increase the risk appetite by further regulatory incentives.

In general, governments should play a catalytic role to create a jump start and not by direct intervention. Boosting demand through entrepreneurship and increasing supply by funding and certification eventually creates a ‘Virtuous Cycle’ (Lerner, 2009). Thus, policy recommendations should integrate three components of entrepreneurial finance (financial vehicles, supporting innovative education, in a hospitable legal environment) and their institutional complementarities to enhance the PE/VC market and support its role in the development of the region’s economy (Eid, 2006).

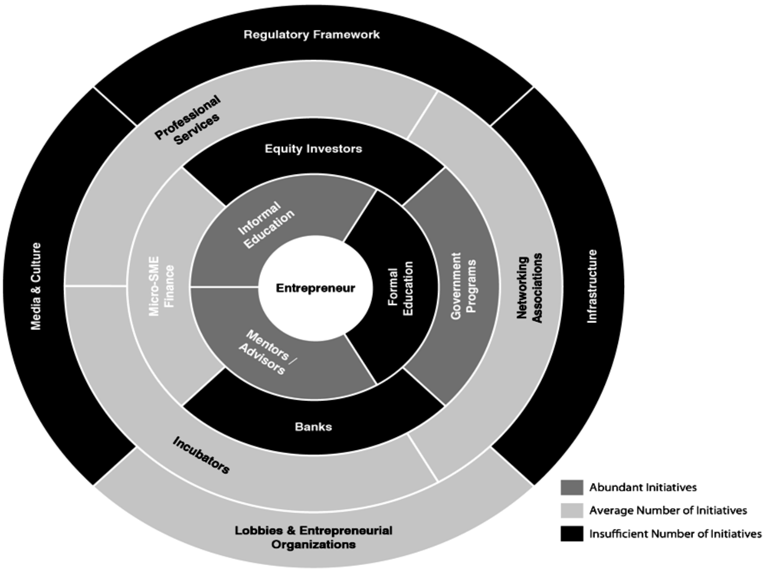
It was further observed from most of the interviews including financiers, industry professional and policy makers that there was an awareness of the need for an integrated entrepreneurial ecosystem. Furthermore, there was a need for government support to create a healthy environment to foster both entrepreneurship and innovation. The most important aspect was to develop an integrated clear programme with clearly defined objectives. This programme should include entrepreneurship education, stir innovation, create incentives and improve the regulatory barriers, and create a funding programme in the form of a fund of funds to support entrepreneurial financiers. There was a consensus that the current government support was insufficient on both the financial and non-financial aspects. According to a board director of a major business association:

"The role of the government should be bigger... they have made some initiatives to support SMEs... they try to create incentives for banks to finance SMEs but banks were reluctant to finance start-ups..."

A VC/PE director commented on the non-financial government support and indicated that the most problematic part is lack of consistent regulations and strategic vision. The majority of industry professionals expressed the need for a single governmental body to support and syndicate the current initiative on SMEs and entrepreneurship and to create and implement a single strategic vision representing the government side. *"Egypt is going to have to develop its small and medium-sized economies. It needs to become a formal, organized and highly professional chunk of the economic pyramid."* (Founder of Cairo Angels: Solovieva, 2012).

For further illustration on the entrepreneurship ecosystem in the MENA region, figure (7.3) shows the development of the different stakeholders affecting the ecosystem (Sayed, 2013).

Figure (7.3): The Entrepreneurship Ecosystem in the MENA Region



Source: Sayed (2013): Booz & Company

There are currently five institutions with considerable roles and responsibilities in SMEs and entrepreneurship eco-system in Egypt; SFD, Ministry of Investment, Ministry of Finance, Ministry of Trade and Industry, and the Ministry of Higher Education and research. However, there is no single body or committee dedicated to coordinate all the policy initiatives taking place (OECD, 2010a). *"Ambiguities in the delegation of responsibility and task assignment pose a risk of policy gaps, overlaps, and the duplication of policy measures"* (OECD, 2010a).

7.8 Accommodating Cultural Difference

There was the problem of 'importing' foreign models regarding entrepreneurship and entrepreneurial finance. An industry professional argued:

"I believe we should make use of such norms and experiences, learn a lot out it, however put it somewhere in the back of his head and then never think of it again; we should think with a pure Egyptian mentality! A pure Egyptian mentality! A unique setup... totally think as an Egyptian who knows the Egyptian market and how to deal with it...".

There was a unique VC firm through the course of this research. This investment company had roots since the 1960s in partnering with entrepreneurs and providing them with essential capital and technical and managerial assistance. They have 17 projects under management worth approximately a capital of 100 million Egyptian pounds. It is a family run business with 16 employees including family members. They have already exited from 6 of their investments, three of which were successfully sold to bigger firms and three were a management-buy-in to eliminate losses. Until recently exit have not been their primal objective to realise profit, however from their previous experiences this has been the major source of their capital gain. Those indigenous models should be encouraged, especially that they don't just target IT investments and argues that traditional industries yields 20-30% annually.

An industry professional argued*:*

“Here the model needs to change we can't just copy the western model... the western model have strong institutions... a strong stock market, banks, and VCs evolving over years.. Their culture is different you can drop out education start a venture and be the most successful... they rely on consumption and debt... surplus is limited... in our case culture is different... we have to put something aside... and you'd be clever to use it... buying gold coins or any gold... when you get more you'd by an apartment for the kids… we follow wealth accumulation... when a good opportunity arises they're in...”.

It was suggested that a government fund of funds that would yield higher averages than the banks would be highly appealing to the masses. Accounting for Shari’a compliance would be a supporting factor for both the individuals and Islamic funds. Building on the charitable and cooperative nature of the society, highlighting the employment effect and economic impact of this fund could be of support. Nevertheless, the previous policy recommendation and accommodating the cultural distinctiveness of Egypt would support entrepreneurship, entrepreneurial finance, and creates opportunities for a vivid VC industry.

7.9 Conclusion

There VC industry is growing worldwide (Bruton *et al*., 2005; Wright *et al*., 2005), and the shape of this growth varies across countries (Ooghe *et al*., 1991; Bruton *et al*., 2005). There is a growing interest in VC activities as an economic growth engine in the MENA region (Eid, 2006; OECD, 2006). Indeed, the PE/VC industry has been growing at a high pace during the past decade in the MENA region (Morales *et al*., 2011), and an observable tendency towards early stage VC activities are taking place (MEPEA, 2013). Egypt has always been a significant player in the regional PE/VC markets; however, the economic and political challenges are affecting the growth of the industry. There was found several challenges and opportunities on both the VC-industry level and firm-level that are shaping its current development. Similar to the previous findings on entrepreneurial finance in general, the regulatory framework would be considered the major hurdle toward a VC industry. In addition, the normative and cognitive dimensions could be guided by further regulatory adjustments. However, an overall positive outlook on the normative and cognitive level was expected to support the growth of a VC industry. The policy recommendations discussed in this chapter are aspired to assist in the growth of the VC industry accommodating the cultural and normative dimension of the Egyptian society to 'factor in' such determinants in the light of the current institutional determinants.

"It is definitely evident that Egypt has all the prerequisites to un-leash a huge potential with its rich pool of ideas driven by a smart and educated population, natural and industrial resources, diversified economy, hundreds of thousands of SMEs… All it takes is a collective, focused effort with smart objectives and a reforming of mind-sets and regulations…" (PE/VC director).

Chapter Eight: Conclusion

8.1 Aims and Key findings

The primary purpose of this thesis was to generate a thorough understanding of the extant entrepreneurial finance in Egypt. The research explores the major impediments and enabling factors shaping its current status. Moreover, it answers why Egypt has not been able to develop a venture capital industry as would be expected in comparison to the MENA region and other developing countries. In achieving the aims of this research, this study had three main objectives.

The first objective was to explain the current status of entrepreneurial finance in Egypt by mapping the financial alternatives and the institutional determinants shaping it. The first research objective was fulfilled through exploring the domain of entrepreneurial finance. From previous findings and discussion in this thesis, it was apparent that there are many concerns regarding banks' support to SMEs in Egypt. Moreover, banks were found to be risk averse towards SME banking, albeit the regulatory changes by the CBE amendments and the formation of credit guarantees and credit rating. On the demand side, SME firms' imbedded difficulties in the form of scale, lack of collaterals and opacity were among the hurdles to match banking requirements. In addition, fear of legal consequences, negative social image, and religious preferences were among the reasons why entrepreneurs might be apprehensive towards banking finance. The leasing industry was found a significant and growing tool and was positively perceived by industry professionals and entrepreneurs alike. *Shari'a* compliance was among the positive factors towards leasing, however, the high involvement of the banking sector in the industry was found negative due to the perceived inflexibility in banking selection criteria.

Bootstrapping in the form of personal loans and credit cards was found to be a common practice among entrepreneurs in Egypt. Deferred cheques were also common in delaying payments and gaining credit from suppliers which was argued by industry professional that the extent and significance of deferred cheques in Egypt might be a distinctive feature of the Egyptian market.

Among a few governmental initiatives, the SFD and Bedaya fund were found to be of potential significance. However, the SFD was mostly involved with micro enterprises and was criticised for red tapes, low level of technical support, inclined towards micro loans, and once more high bank involvement. The SFD was strategically getting involved with equity finance while developing its human resources. On the equity side, Bedaya fund and the NILEX were found to be in an early stage with little impact on the entrepreneurial finance arena in Egypt yet with a positive outlook if properly utilised.

The informal financing and love money were found reasonably substantial in Egypt. In respect of ‘love money’ there was a ‘taken for granted’ attitude for financial family support that would extend beyond direct family members, signalling a cooperative behaviour among the society members. Other signs of society cooperation were evident, such as the rotational saving and lending *‘Gami’a’* model. It was a well-established household activity that was applied mostly among small businesses signalling another cooperative approach based on trust and close social networks. Among other forms of informal financing was partnership as a source of finance and not for any other value adding activity.

Crowdfunding was also present in Egypt reflecting a globalisation effect and high pace of knowledge transfer. In addition, the business angel concept was also found, yet different from the habitual model. However, a group of angels recently formed a consortium of angels that was found similar to the western model found in Europe and Anglo-Saxon economies.

Although HGEs are the most significant to a country's economic development and the highest contributor to job creation; sufficient funding among other factors is vital for their growth (OECD, 2013). However, it remains that potential high growth enterprises in Egypt are facing many challenges over and above the challenges facing start-ups and entrepreneurial ventures in general. Undoubtedly, insufficient funding is among those major challenges.

According to an entrepreneur:

"We [Egypt] might have plenty of courageous entrepreneurs but less educated capable entrepreneurs that can really build a company... but those who can scale and impact the economy and create jobs, we do have a problem in this category...".

Furthermore, the first research question on the main institutional determinants shaping entrepreneurial finance in Egypt was answered through identifying the major hurdles impeding, and conducive factors supporting, the development of entrepreneurial finance in Egypt.

Among the obstructive determinants were Poor level of Education, training, and entrepreneurship education. The importance of entrepreneurship education is clearly evident (Kirby, 2004) and it was considered by most interviewees to be a major obstacle towards entrepreneurship in general and subsequently entrepreneurial finance. Lack of professional associations and westernised influence was also found to be another obstructive determinant. Westernisation was taking place among the whole society (Amin, 2000) and it was no surprise to affect the entrepreneurial finance domain causing difficulties to accommodate cultural differences. Furthermore, it was found that there was an abundant family owned enterprises which lead to lack of corporate governance. This was perceived as a major obstacle by financiers to fund potential ventures. Among the cultural barriers, there was a weak legitimacy towards entrepreneurship career which also hindered entrepreneurial activities. In addition, low level of innovation was clearly evident. According to Xavier *et al.* (2013), R&D and innovation are vital for entrepreneurship and economic growth. From a regulatory perspective, the business environment in Egypt was unfavourable and cumbersome with weak rule of law, similar to the findings of McMullen *et al.* (2008) and Li and Zahra (2012) as hindering aspect towards entrepreneurship. Moreover, an unsupportive bankruptcy law was another clear hurdle towards entrepreneurship in Egypt. The role of bankruptcy on entrepreneurial activity is evident in the work of Armour and Cummings (2006). Moreover, there were no laws governing entrepreneurial finance (VC, crowdfunding, Angel investment), nor were there any privileges or tax exemptions for their funding. Another regulatory obstructive factor was the inefficient intellectual property rights laws and protection.

On the other hand there were conducive factors that supported the development of entrepreneurial finance in Egypt. There was a positive perception towards entrepreneurship and the society valued a successful entrepreneur. Another conducive factor was the viability of informal networks compensating lack of formal ones, similar to the findings of (Peng and Zhou, 2005); nevertheless heavy reliance might inhibit business transactions (Peng, 2003). In addition, there was a notable presence of indigenous developmental organisations supporting the domain of entrepreneurship and entrepreneurial finance. Furthermore, the Islamic finance influence supporting risk taking and equity financial tools was found an influential factor supporting equity financial vehicles funding entrepreneurial ventures. Another Islamic and cultural conducive aspect was found to be the charitable practices induced by Islamic and cultural behaviour within the Egyptian society. Among the cognitive conducive forces was the bottom-up problem solving behaviour supported by the findings of Schroeder (2013). This behaviour supported the presence of many indigenous feasible ideas that were capable of solving deeply rooted problems among the society. From a regulatory perspective, there were clear efforts on restructuring and development of the financial sector by the Government of Egypt, and observable attempts on creating a favourable ICT infrastructure.

Regarding the second objective of the research, it was to understand the development of the venture capital industry, through the surrounding institutional factors affecting its growth. The second objective was fulfilled through exploring prospects of development of a venture capital industry in Egypt. Using an institutional theory lens, factors supporting the VC industry were similar to the factors affecting entrepreneurial finance in general earlier explored such as the positive perception of entrepreneurship, informal networks substituting the formal, Islamic *Shari'a* compliance, and cooperative and charitable nature of the society. However some specific factors were found conducive to the development of a VC industry, such as relative development of financial sector and relative depth of capital markets, which was found in line with the findings of Jeng and Wells (2000) to be more supportive to PE activities than early stage VC. However, they remain an important pillar for the development of VC industries worldwide.

Regarding inhibiting factors towards a VC industry in Egypt, was lack of a VC association and a clear shortage of VC industry specialists. Other general aspects affecting entrepreneurial finance in general as well as a VC industry was lack of innovation and insufficient education. The regulatory dimension was found to be particularly inhibiting the development of a vivid VC industry in Egypt. The cumbersome bankruptcy laws and no capital gain preference, supported by the findings of Gompers *et al.* (1998) are crucial determinants for success of VC industries worldwide. Over and above, there were no incentives or rewards for risk investors and insufficient R&D support. Lack of such policies and governmental initiatives are once more a clear hurdle for countries considering developing a VC industry. Similar to the previous findings on entrepreneurial finance in general, the regulatory framework was considered the major hurdle toward a VC industry. In addition, the normative and cognitive dimensions could be guided by further regulatory adjustments. However, an overall positive outlook on the normative and cognitive level was expected to support the growth of a VC industry.

The third objective was to develop policy recommendations for an Egyptian venture capital model that would better fit the case of Egypt in the light of the current institutional forces. According to Lerner (2009), several efforts took place around the world unsuccessfully trying to imitate the US Silicon Valley model. It is vital to understand the unique circumstances and requirements of each nation to promote entrepreneurship and entrepreneurial finance. However, it remains a strong case to confirm to global standards to be able to attract international entrepreneurs and VC investors (Lerner, 2009). This research objective, for the case of Egypt, was fulfilled through ten policy recommendations elaborated in section (7.7), in summary, 1- Enhance entrepreneurial activities and idea generation. 2- Differentiating between HGEs and other entrepreneurial ventures should be well identified and addressed. 3- Stimulate supply of VC funds. 4- To enhance the capital markets. 5- Improve the regulatory framework. 6- Give political support and VC awareness by promoting a fund of funds for VC investments. 7- Create technology based clusters and capitalize on technology enabled new ventures. 8- Introduce training programs for VC specialists and certification via EFSA and support building a VC association. 9- Enhance R&D in universities and introduce entrepreneurship education syllabus from early stage education. 10- Accommodate and 'factor in' cultural dimension such as *Shari'a* compliance and cooperative nature. It should be well noted that implementing such recommendations is a long process. Moreover, all these recommendations are intertwined and interdependent. According to Scott (2002), the regulatory determinants are the easiest to change and most observed. Thus such recommendations should commence with regulatory changes on the short run and then further objectives, whether educational, training, or cultural should be incentivized and eventually assessed on the medium term. The whole set of recommendations is an ongoing, long process and a direction for enhancing entrepreneurship and entrepreneurial finance.

Thereby, the three objectives of the research are fulfilled in the finding and discussion of this research. The following section summarises the discussion of these findings and objectives.

It is worth mentioning that during the recent socio-political changes that have taken and are taking place in Egypt and some governmental efforts over the preceding decade, many changes have taken place in the domain of entrepreneurial finance. The more dramatic changes that occurred post the 25th of January revolution enhanced such changes, entrepreneurial finance and entrepreneurship in general experienced unprecedented attention. After researching the available financial tools and supporting activities, it was found that many interested organisations, associations, and individuals have shown a high level of interest in entrepreneurship domain. During the years of the course of this research between 2008 and 2013, it was clear that the post revolution period was the most dynamic and showed a significant momentum towards entrepreneurship and entrepreneurial finance. The period post-revolution witnessed the creation of several business incubators/accelerators, electronic platforms, media materials, crowdfunding, organised business angels' efforts, and dedicated VC firms. Moreover, developmental SME financing companies as well as SMEs specific leasing companies were established. All of which have the potential to help in the development of a thriving entrepreneurial eco-system.

However, there was a setback in the demand side, not that there is insufficient demand, but that there is a mismatch of demand and supply in regard to entrepreneurial finance. Lack of innovativeness and the relatively small number of high growth enterprises is inhibiting the flow of venture capital that might exist in regional and international markets. The opportunity of utilising Islamic tools alongside the appetite for risk and entrepreneurship tendencies exists, yet to find good opportunities was the real challenge. Nevertheless, with new technologies and the current momentum in Egypt and the whole region there is a potential for the current environment to improve.

A major challenge was to attract investments towards the venture capital industry and enhance the supply of capital to high growth enterprises. Building on success stories and creating industry champions would be of support and would increase the appetite of investors in venture capital. On the policy level, there is a pressing and urgent need to have a synchronised programme to capture and arrange all the programmes, initiatives, and efforts exerted on entrepreneurship in Egypt. Such programme should include an entrepreneurial finance and VC initiative in the form of a fund of funds to work simultaneously on the supply and demand side of venture capital. At the moment, many developmental agencies are aware of the opportunity and necessity of a venture capital industry in Egypt, however, the industry will not grow without the involvement of institutional investors, HNWIs, family offices, international and regional VC firms. One of the main impediments is regulatory issues; there is an urgent need to facilitate laws and regulations to start-ups, ease of taxations, labour laws, social insurance, and other cumbersome licences and permissions. Over and above a full revision of bankruptcy laws and their legal consequences is paramount to decrease the fear of failure towards entrepreneurship. The financial regulations need to be altered to accommodate a favourable venture capital fund setup and fund management companies with a specific notice to capital gain taxes and other protections needed by VCs to operate such as minority shares rights.

There is a shortage of innovative start-ups in the region, however, high innovation is not a prerequisite for start-ups, technology enabled ventures have proven to solve indigenous chronic problems in Egypt and were successful on financial returns. Thus remains, an Islamic VC fund with a charitable drive might help to close the gap of entrepreneurial finance in Egypt and other MENA countries. It can be a start for a VC localised model in the region and a start for an aspired integration between the resource rich countries and resource scarce yet with an educated growing population. Nevertheless, a sustainable and profitable model should be the primary objective of the suggested funds and the social impact should be a supporting feature.

Finally, the distinctive Islamic component of the region and Egypt can surely play a significant role in promoting a VC industry. The fact that venture capital naturally complies with the *Shari'a* law; in addition to the charitable dimension along the interest free notion can be decisive aspects in the establishment of the industry. Building on the magnitude of capital dedicated to Islamic financial tools and directing it towards a VC industry might also have a social impact on the region's societies, and thus could be considered within the scope of social responsibilities of Islamic funds. Such Islamic funds are capable of helping the staggering number of unemployed youth in the region and will have an economic value and feasible financial returns.

8.2 Further Implications for Theory and Practice

The theoretical implications of this research directly contribute to the work on institutional theory and its usage. It adds to the literature utilising the theory in industry analysis in emerging economies and especially entrepreneurship and the VC industry. In addition, it enhances the literature of entrepreneurial finance and entrepreneurship in general. On the practitioners' level, it seeks to assist investment decisions of entrepreneurial financiers and entrepreneurs operating in Egypt, whether local, regional, or international. Through identifying the major sources for entrepreneurial finance as well as the cultural and normative determinants in Egypt, it is believed that it supports decision making for market entrants regarding entrepreneurial financiers. Moreover, it recommends policy changes to improve the current entrepreneurial finance environment and enhance the emergence of the VC industry and consequently promote entrepreneurship and innovation in Egypt.

Using institutional theory as the lens for analysis was found highly beneficial in assessing the effect of the institutional forces on the development of the VC industry and on the investment decisions of the present venture capitalists in Egypt. Further theoretical utilisation was found to be resource dependency theory in the case of investment companies competing for resources (Funds). To be able to survive through management fees and capital gains, they tended to be more generalist and 'opportunistic', hence follow the appetite of investors more than their own strategy or focus. Investment companies were fragile and dependant on the HNWIs behaviour and preference, where VCs found difficulties in acquiring such resources. The findings of the research would agree with the suggestions of Wright *et al.* (2005b) on using institutional perspectives along with the resource based view for a better understanding of the behaviour of VCs across countries.

Furthermore regarding theoretical implications, was the preference of equity financing over debt financing for some entrepreneurs. This appears to contradict conventional financial wisdom and Pecking order of financing. A pecking order indicates that the cheapest source of financing is through debt and therefore it should be the first choice for entrepreneurs. In the findings of this research, a sound preposition would argue that cultural values and personal beliefs might act against the best financial rewarding method. Hence, behavioural finance could be a plausible discipline for further understanding of this matter.

8.3 Contribution of the Research

Although there is a growing literature on entrepreneurial finance and the worldwide VC expansion and VC behaviour in emerging economies, it is apparent that many regions in the world are still under researched. There is 'virtually' no research on VC in Africa, Latin America and Oceania (Bruton, Fried and Manigart, 2005). Also, there is sparse academic literature on the MENA region concerning entrepreneurial finance or venture capital. Hence, there is a gap in academic literature for the concerns of entrepreneurial finance and VC/PE industry in the MENA region in general and entrepreneurial finance and the VC industry in Egypt in particular. As little is known on entrepreneurial finance in the Africa and the MENA region, this research contributes to knowledge of entrepreneurial finance and venture capital in those regions through the case of Egypt. This study generated an understanding of the current situation of the VC industry and its environment in Egypt, as an integral part of the MENA region. The thesis examined its growth while relating to the literature on developed VC markets. Moreover, it explains the growth pattern of the industry; what is inhibiting the industry's development and what can be done to enhance its growth pace. The grounded theory approach in data gathering, through combining the primary data via interviews and participant observations with the secondary data, is believed to have created both the depth in knowledge concerning entrepreneurial finance and the VC industry and the breadth needed to comprehend the whole topic. The researcher being 'grounded' to the data through observations and interviews with entrepreneurs and entrepreneurial financiers initiated a bottom up approach. This approach enabled in depth understanding of the why questions behind the observations. Combining the primary data and secondary data enabled triangulation of the findings for further validation. Moreover, triangulation among the multiple informants of the data gave further validation.

In addition, this thesis partly captured the Egyptian entrepreneurial environment during and after the January 25th revolution in 2011 where the socio-economic and political environment in Egypt was heavily influential. This thesis might well be amongst the early academic researches undertaken in Egypt as well as the Arab MENA region focusing on early stage entrepreneurial finance and venture capital. Moreover, the thesis utilises secondary data through GEM reports and the recently formed PE and VC regional associations which was of valuable addition to this research. Those reports were not available to prior studies on the region, hence giving helpful insights on entrepreneurship and VC industry in Egypt and the MENA region. Although the data was not gathered for scientific research, they still remained of value for facts and figures and for validating the findings.

8.4 Research Limitations

Limitations of the study were in the nature of the VC industry in Egypt as well as most developing countries. The data opacity, newness of the industry, and the small sample of the population restricted the data gathering away from running rigorous statistical analysis to assess the development, performance, and behaviour of the VC industry in Egypt. Another limitation would be the case specific nature of this study, although the MENA region has lots of common characteristics; however, heterogeneity amid some of the countries was quite obvious. Consequently, the results from this study can neither be generalised on countries of the MENA region nor any other developing country. In addition, the timeframe of this study is another limitation for the ongoing and dynamic process of change in the industry, as well as the slow nature of institutional changes that were captured over the time of the research. Over and above, this research was made partly before the January uprising in 2011 and partly after that until the end of 2013. The political and socioeconomic nature of this period is to a great extent unique, consequently the volatility of the Egyptian situation was far beyond capturing completely. Therefore, some of the results of this study reflect the outcome of the data that are collected in these specific years and thus once more cannot be generalised for the country or the region at all times. This study is intended to serve as a guideline for entrepreneurial finance and VC in Egypt, as part of the MENA region and as a developing country, to identify the strength and weaknesses affecting its growth and set the course for its development. Thus this research should remain ‘generalisable’ within the scope of time and place of the study and not beyond it. Therefore, the limitations earlier discussed do not affect its core objectives and the research should remain of value to both theory and practice.

8.5 Direction for Future Research

During the course of this study, several topics were covered regarding entrepreneurial finance. More depth on some of these topics is suggested to be beneficial for future research. The apparent gender gap towards entrepreneurship in the MENA region and specifically in Egypt needs further understanding from a cultural perspective. There has been the work by Hattab (2012) on the gender gap, however further research is believed to be needed for more understanding. The topic on the informal angle financing although needs a more in-depth study. The amount of ‘love money’ would be a good start for exploring this domain. The topic of business angels was covered on in the GEM report (Hattab, 2008), yet remains an under researched area on entrepreneurial finance in Egypt. The profile and motivation of business angels are among the topics that need such clarification, especially in the light of no tax incentives rewarding such behaviour. Regarding SME finance and capital structure preferences, study of a larger sample of SMEs for further understanding of their preferences and the reasons for such preferences. The impact of Islamic finance influence on external finance choices of entrepreneurs could be another study for future research. Regarding the VC industry, a future longitudinal empirical analysis on the effect of the regulatory framework such as corruption and tax policies on entrepreneurial activities and VC industry in Egypt could be of benefit to assess the development, if any, on promoting a VC industry in Egypt.

This research took place during highly turbulent time in the history of Egypt. However it turned to be highly interesting to the researcher to be able to capture such unique circumstances. Although the turmoil might have caused several challenges, yet the highly dynamic environment enriched the findings of this thesis. If the researcher was to take this work again, it could have been beneficial to focus more on the demand side of capital (entrepreneurs). The cultural aspect was of specific interest to this research, which was found apparent and reflective in entrepreneurs rather than financiers, policy makers, and industry professionals. Furthermore, the sample of entrepreneurs was illimitable and more accessible contrary to entrepreneurial financiers and policy makers. In addition, a mixed method of quantitative and qualitative could have supported some of the findings, specifically the preference of capital structure and the effect of *Shari'a* on entrepreneurs' choice of sources of funding. A larger sample with gathered via questionnaires could have supported such findings. However, the value of a qualitative approach remained to be paramount and indispensable to this research and possibly for further research covering cultural and cognitive aspects in regards of entrepreneurship in general and entrepreneurial finance research in specific.

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Appendix A

Interviews' Questions: Venture Capital in Egypt

Market Level:

1. How would you define the nature of your business? i.e. Private Equity or Venture Capital.
2. From your point of view, what are the major differences and similarities between the two?
3. What is the current position of the VC industry "in its broader definition" in Egypt?
4. What is the impact of the industry on the Egyptian economy?
5. How do you perceive its development compared to MENA region and other developed markets?
6. If any, what are the current factors affecting its growth? How would you rate them?
7. If any, what are the major challenges facing the industry? How would you rate such challenges?
8. What would you suggest to improve the VC environment?
9. In particular to early stage investments, how do you describe the current market position?
10. What are the obstacles facing early stage investment? How can they be approached?

Firm Level:

1. What is the current strategy of your firm? (regarding stage, size, and sector of investment)
2. What is the rationale behind your strategy?
3. Why or why not do you consider early stage investments?
4. How do you assess the inflow of capital? What are the major sources of funding?
5. What is the relationship between the fund investors and your firm? (compensation and restrictions)
6. How do you assess the pipeline of new ventures? Do you find this problematic?
7. What are the main sources of new ventures?
8. What are the main screening methods?
9. What are the main valuation methods?
10. Do you consider syndication with other firms? Why?
11. What is the level of involvement with investee companies? (hands-on/off, time allocated, and geographical closeness)
12. What are your main value-adding activities? How would you rate them?
13. What are the main covenant issues? (staged financing, preferred/convertible shares, anti-dilution, majority position, board seats, rights to sell)
14. What is your main exit strategy? What are the problems that you face in exit?
15. What policies would you suggest will improve your company's performance?
16. What are the regulatory concepts that you find most problematic?
17. What is the impact of *Shari'a* on the whole cycle of investment?

Policy Level:

1. Where does the VC industry fit in the business development agenda of the government of Egypt?
2. What are the major impediments that are hindering the industry?
3. What are the current changes that will enhance its development?
4. What are the current regulations to set up a VC fund and firm management? How adequate are they in the light of international standards?
5. Regarding taxation policies, is there any change in the current policies that will impact the industry? (especially capital gain tax and early stage ventures' exemptions)
6. What are the current initiatives to promote the industry?
7. What are the actions taken in the process of commercial law enforcement and intellectual property rights?
8. What are the current initiatives to promote entrepreneurship in general?

Entrepreneurs:

1. Are you familiar with the concepts of venture capital?
2. Do you consider it as an option for your growth strategy? Why and why not?
3. What can be changed to make you consider VC funding?
4. What other sources of funding would you prefer?
5. Does the fact that it is *Shari'a* compliant affect your decision?

VC backed Entrepreneurs:

1. How did you know of your current VC investor?
2. How did the investment process take place?
3. What are the major challenges that faced you? And how did you resolve disagreement issues with the VC firm?
4. What is your level of decision making?
5. To what extent is the control of the VC firm exercised? How comfortable are you with it?
6. Overall do you find it a feasible experience?
7. If you had that chance to do it again will you still choose VCs as your partners? Do you consider repeating the same experience with a new venture?

Appendix B
Transcriptions Sample

Part of Interview VC/PE (2):

- I prefer the SMEs definition used by the Nilex, it is the most convenient. There are actually many criteria for such a definition and I personally see it as a waste of time. Some suggest it is according to no. of employees which is actually ridiculous. Some company have a team of seven and they manage billions of assets such as PE firms. Also the turnover is not sufficient as some companies have a paid in capital of 5 million and a turnover of 100, 200 or even 300 million with a very slim margin of 2 or 3%. I am convinced that the paid in capital is the most relevant. It is not really a condition for us to have a certain size to work with, it is more of a mix of paid in capital and turnover so our limit will be a max of paid in capital 100 million and a turnover of 300 to 400 million which makes it a medium size and not a large company regardless of the profitability.

- The way I'm seeing things are different if we focus after the January revolution, the past three years, or the past five years. PEs in Egypt are, from my point of view, dead. Or we can say stuck, the multiples were high prior to the revolution and the transactions were valued on such high multiples. It was more like the real estate market, no one wants to realise the real value and the buyers don't want to realise any losses. This caused stagnation in the market and thus there was almost no transactions taking place during the last three years. Especially after the financial crisis as one used to hear about 1 or 2 transactions by max. I see the opportunity in both PEs and VCs catering SMEs, yet there should be a certain formula to be developed for catering such business which is different than the one for midcaps, it has to be adjusted to be a win-win and becomes profitable to the investor. I have a certain belief that the SMEs and not micro can be a source of huge money, as it is much easier to help and help to grow the entrepreneurs and family businesses.

- Value can be created by adjusting organisational charts and applying corporate governance, proper financial restructuring and proper management. However applying corporate governance itself will be of great value, yet one of the main challenges you'll find is that entrepreneurs and business owners usually handles the financial and sales activities themselves. Therefore applying corporate governance in itself in SMEs can be found problematic. This hinders the growth although the great potential and its need to grow. The age bracket of such entrepreneurs is between 30 till 45 where he struggles to grow using consultants and seeks all support.

- External factors that do not support the SMEs environment are regulations, taxations, and surprisingly the understanding of the different bodies that are claiming they are supporting SMEs do not understand SMEs. I personally believe there should stem from a single body or an authority.

- The financing tools are the main issue; the banks for instance still don't want to finance SMEs as it really should. Usually the effort needed for financing SMEs are larger than the efforts for large companies, they need supervision, and thorough support. I see that leasing companies are handling SMEs in a much better way, and they have gone a long and successful way compared to banks and PEs. The PEs are actually tragic in regards to SMEs, they are all white collars and they don't want to really understand the needs of entrepreneurs, it's not private equity! It's more of a business development issue. One needs to be a hunter, the investor should be capable of that, and one can't perceive this as portfolio management. There is a distinction between PE, VC and business angels, yet angel investors could usually play the role of VCs therefore there should be separate funds for both of them.

- There are norms for such industries. Such norms can be applicable in Europe and the states, maybe the Eastern European experience could be of some relevance to us, maybe the Gulf region as well. I believe we should make use of such norms and experiences, learn a lot out it, however put it somewhere in the back of his head and then never think of it again; we should think with a pure Egyptian mentality! A pure Egyptian mentality! A unique setup, totally think as an Egyptian who knows the Egyptian market and how to deal with it.

- There are many criteria from a VC perspective, first is the industry and here we have many common factors with the international perspective to different industries and their profit margins. Second is the regulatory system, it is a very serious issue and here you need to think with a local's mentality. The whole covenants issues here in Egypt are inapplicable; usually you need to manoeuvre by creating an SPV that is governed by a more efficient regulatory system. Third is the taxation systems, you also need to create novel solutions to overcome capital gain taxes issues. Such issues can be overcome by an Egyptian tax expert. Someone with an Egyptian exposure that knows his way around and not a person from the international companies. Here as well the localisation of such knowledge is highly important.

<u>Part of interview VC/PE (4):</u>

- The world structure of LP/GP is not in the egyptian law.. And this is why we resort to offshore, we establish the GP offshore however we can establish the fund in Egypt and this what we did.. we do this in the form of regular stock joint companies.. for instance we made a retail fund, it was a company under law 159 specially that in retail we need import permits and thus it had to be an egyptian owned company.. and according to the law it's permitted that I invest in other companies that work in the same field.. So mostly we addapt to the requiremets of the fund we work with..

- We are longterm investors, in general, our exit ranged from 7 to 12 years, sometimes earlier but in capital we are in the housing company for the fourth year now.. and we're not planning to exit now.. we still see we can develop.. we have a different approach than many pe in the region.. we get really involved and very close to the management of the company.. yes we would consider ourselves hands-on.. our major investor is a businessman.. he's an ex industrialist, he's not a banker you know what I mean.. He's one of the Shareholders long time ago and has different investmenst.. His family have diversified investments.. when they totally divested.. he created the private equity firm.. they sold stakes gradually till he totally divested a year ago.. and he focused on the pe business.. totally devoted.. by his nature he's hands-on and operational.. he understands operations.. we prefer to have a role.. there must be a value add I offer, it's not only money.. I have to bring something to the table..

- I do it and I'm not a saint.. I focus on exit.. specially smes they are used on a certain pace.. It takes me time.. I have to start with this so he gets used to it.. so when I exit the company would be well structured have a system.. even if it's publicly listed it would be ready.. Deal sourcing is done throughh many ways.. one is through referals with current investment banks and boutiques.. we have some sort of agreement with some of them.. with the midcap funds because they're all istitutions they asked to make a contract with one or two.. one was a bank who is also a share holder and the other is an investment botique who is also an adviser of the fund.. they both get us referals.. we also go and screen ourselves and approach by ourself..

depending on the criteria of the fund.. we have someone who is dedicated for this job.. yet we all do that.. me as a partner as well as the other partner 3/4 of our time we do business development.. between business development and monitoring our investment.. investment directors are responsible for 2 or 3 investments maximum.. he follows up with the managament he governs.. he can also be a board member.. we choose who are capable of being board members who are not we try to develop him to be a board member at one point in time.. we can't be board members in all.. we (partners) can be board members, they (investment directors) can be board members, sometime it's both depending on the board representation.. Trust is the base, it's the most importanat thing we do..

- We were burnt at some times.. we made it a point that this is a partnership.. I know we're there for sometime and we'll exit.. but at the end it is a partnership.. if there is no chemistry forget it.. even if it will profit me 200 million pounds! we entered in an investment lately and we didn't complete 4 months.. very soon there was foul play and problems.. and we took it to a legal dispute.. it was solved by metigation and settlement.. but why did it happen, it was a misjudgement.. we couldn't cooperate with this partner.. it came against our expectations.. we really take good care that the management or partner there is chemistry and understanding we take sometimes a long time to know him and letting him know us.. how we deal with things how we think all this is very important.. from our experiences the most important factor that makes an investment successful is the partner, it's not the performance or the market.. if you get a long with your partner and we understood eachother well and we started to respond well it goes well.. we have problems, ups and downs.. you can do all agreements in the contract and still you can go bust.. with other partners you can ignore all this and it flies.. It can apply on our investors too but it is not a personal thing it's more of comfort.. there is something called an investment club.. I have a group of investors that I always deal with and those are what investments rotate around.. The biggest source of investors are from high net worth individuals it's like a 60 to 70% of HNWI to a 30to 40% institutional investors..

- I know this might be specific to the region.. it is because you don't have a strong institutional investor.. banks are there but they don't enter.. In the region only Egypt would have a proper pension fund and they are not entitled to invest in such vehicles.. The GCC have soveriegn funds and they would invest with us.. yet their participation is not really high.. uptill now we don't have any.. we do on the level of investment banking, brokerage and funds.... we have nothing to do with that.. we are totally seperated, only joined by the name.. they only own 2 or 3 %.. we have many HNWI in the GCC, plenty.. Saudis, Emaratis, Kuwaitis, Qataris, and Egypt.. but HNWI in Egypt are not many.. or those who would invest.. they are many in general as a number but they invest in their own businesses.. They would mostly do something themselves with their own minset.. they won't give their money to someone else to invest to play it with his mindset…